Deloitte.

Restructuring Central Europe
NPL markets to gain momentum

Contents

Foreword

The debt sales market in Central Europe is gaining momentum. The improving economic situation is attracting NPL investors to debt purchasing in the CE region, due to the expectations of higher recovery rates, which suggests a favourable habitat for distressed debt sales. At the same time, banks are looking for opportunities to reduce risk-weighted assets and the amount of capital they must hold against non-performing loans so that they can increase their new lending to customers with better credit quality. The pace of deleveraging has been increased by the imminent results of ECB's AQR (comprehensive asset quality review) on 26 October 2014, following which it is expected that banks subject to the review will be required to make additional provisioning for NPLs. Local national banks also to run their own 'AQR's, which will speed up measures by banks to reduce their NPLs. Additional provisioning necessitated by the AQR will also reduce the pricing gaps which are often blamed as the main 'deal breaker' between banks and NPL investors, therefore AQR is expected to provide a tailwind for the debt sales market. Pricing gaps will never disappear though, because of the substantial difference between the discount rates applied by NPL investors and banks.

However, for NPL investors this difference in discount rates is compensated by higher cash flows that they can achieve by having distressed debt collection as a core activity and being more flexible and efficient than the banks. Regulators throughout the CE region, supported by international organisations such as IFC and EBRD, have launched initiatives to help banks scale down their NPL volumes through portfolio transactions.

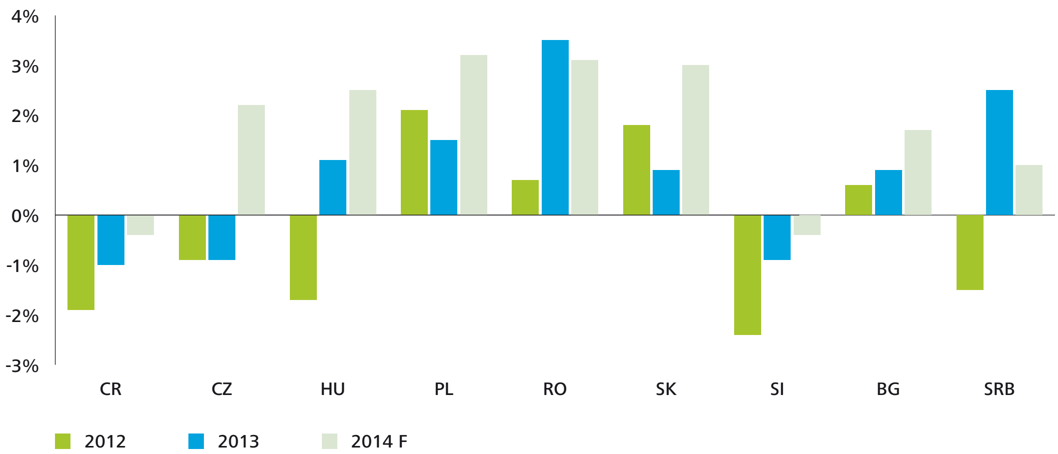
With improving market conditions, portfolio transactions are becoming a more attractive, effective and speedy remedy for banks to deal with their NPL problem. Recent transaction activity in the market has also included mortgage and corporate loan portfolios in addition to more frequent consumer portfolio transactions, and there has been transaction activity in some countries where there has been very limited in the past.

"You need to clean the NPLs, it's as simple as that."

(Lucyna Stanczak-Wuczynska, EBRD`s central and eastern Europe banking expert, Reuters Summit, 30 September 2014, London)

Macro overview

Figure 1. Changes in real GDP, 2012 – 2014 (Forecast)



Source: EIU

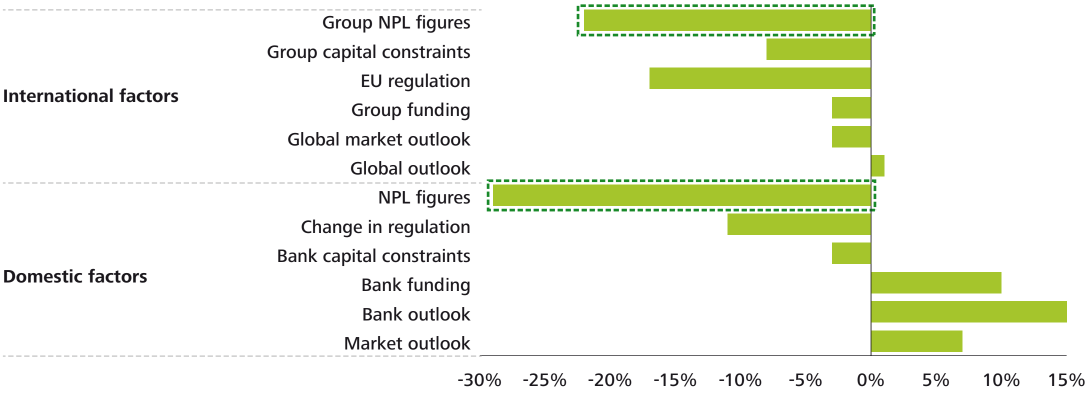
Last year we reported worsened real GDP dynamics between 2011 and 2012 in all nine countries that we studied. This year the picture is markedly more positive: in 2013 there was an improved real GDP performance in six out of the nine countries. In both Poland and Slovakia real GDP increased, although at a lower pace than the year before, and in the Czech Republic it contracted by 0.9 per cent, the same rate as in the previous year. Forecasts for 2014 are for further improvements in all the countries except for Romania and Serbia, which are expected to increase GDP but at a lower rate than in 2013.

The effects of the improving economic conditions and returning optimism can be seen in the debt sales market. Investors are showing greater appetite for NPL transactions in the region due to the higher recovery rates that are expected as the regional economy gains strength. Interest in the buy side of potential NPL transactions is therefore gaining momentum. At the same time banks are becoming more willing to sell, for reasons explained below.

Investors are showing greater appetite for NPL transactions in the region due to the higher recovery rates that are expected as the regional economy gains strength.

NPLs – What next?

Figure 2. Factors contributing to supply conditions in the credit market
(net percentage; positive figures refer to a positive contribution to credit supply)



Source: H1 2014 CESEE Bank Lending Survey of the European Investment Bank

Recovery in the banking sector will depend on the success of the banks in sorting out their problems with NPLs. The European Investment Bank's CESEE Bank Lending Survey (covering 14 countries/15 international groups/90 local banks/approximately 50 per cent of regional banking assets) for the first half of 2014 reported: "NPLs remain a drag on credit supply conditions, and NPL ratios are expected to continue to increase over the survey period. Therefore initiatives to tackle this problem remain a high priority on the policy agenda. The resolution of NPLs is key to engineering a resumption of the healthy flow of credit into the economy."

Huge amounts of NPLs remain on banks' balance sheets, tying up capital and so reducing the amount of capital available for new lending activity to support economic growth. Losses from any increase in provisions that banks make will also reduce their capital base. The EIB's CESEE Bank Lending Survey indicates that the large quantities of NPLs are the factor hindering bank`s credit supply way the most. (See Figure 2.)

The second strongest constraint is uncertainty about the regulatory environment, at both the national and group level. Regulators undoubtedly want to see an end to the NPL problem, and they are likely to intervene with initiatives to find a solution. However the regulatory environment is unpredictable, and banks cannot plan properly or set out a strategic direction when there is uncertainty about what the regulators may require.

The EIB's CESEE Bank Lending Survey, referred to earlier, comments: "With credit quality remaining a constraint on the supply side, more could be done to create the right incentives for banks to accelerate NPL management and disposal."

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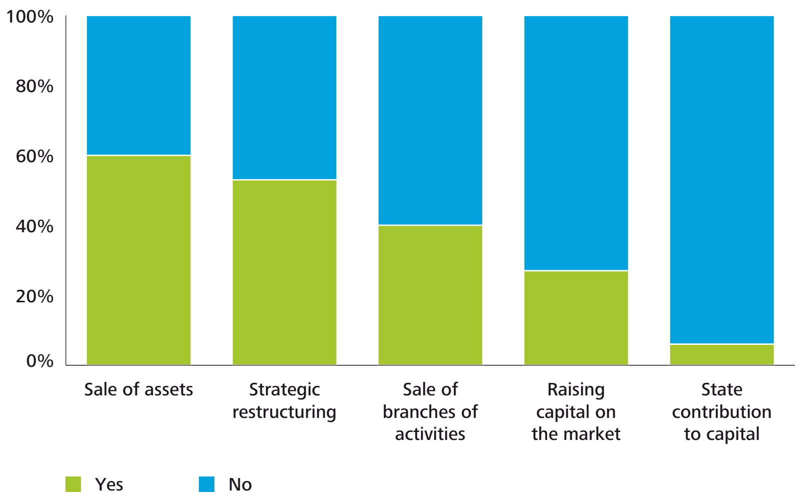
Capital scarcity is expected to increase and come even more to the forefront of the strategic agenda following the outcome of the AQR. The results of this thorough check of the balance sheets and the resilience of the biggest banks will be announced on 26 October 2014. Where evidence from the AQR points to a bank having insufficient provisions against sub-performing loans, additional provisioning will be required that could reduce substantially the bank's capital base. The banks are well aware of this and are considering a number of measures to improve their capital buffer and loss-absorbing capacity. The H1 2014 CESEE Bank Lending Survey of the European Investment Bank found that 60 per cent of banks plan to improve their capital ratio by means of assets sales, about 50 per cent through strategic restructuring and about 40 per cent through branch sales. (See Figure 3.)

In summary, the NPL problem is still acute, and capital remains scarce. Remedies are needed, and portfolio/asset disposals could be a solution. Given expectations of regulatory intervention, banks seem willing to consider this course of action.

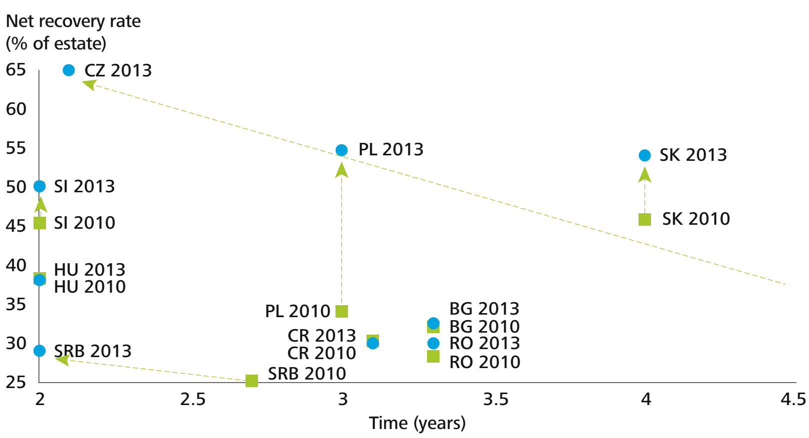
However, the banks may prefer a different method of resolving their NPL problem. For the same reason that NPL investors are attracted to the CE region, banks may decide to keep their troubled loans and manage them in-house in order to benefit from the expected improvements in recovery rates. Against this, banks should recognize that NPL investors can generally achieve higher recovery rates and cash flows, since distressed debt collection is a core activity for them, and they tend to be more flexible and efficient than banks with collection procedures.

Figure 3. Strategic options to increase capital ratio



Source: H1 2014 CESEE Bank Lending Survey of the European Investment Bank

Figure 4. Development of recovery conditions, 2010-2013



Source: World Bank
Note: CZ 2010 point is not displayed for illustrative reasons, as its time data is 6.5 years (net recovery rate is 20.9%).

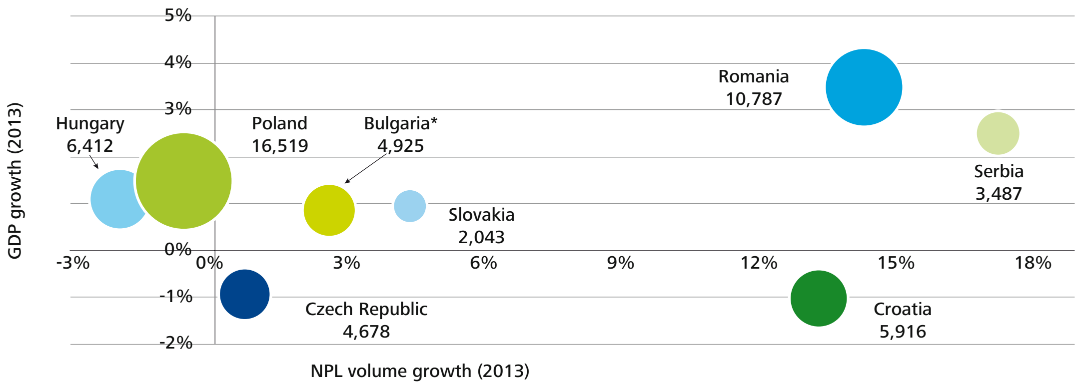
"With credit quality remaining a constraint on the supply side, more could be done to create the right incentives for banks to accelerate NPL management and disposal."

Recovery rates have been slow to improve. There was no improvement between 2010 and 2013 in Hungary, Croatia, Romania or Bulgaria. Over the same period, net recovery rates have improved by about 5 percentage points in Serbia and Slovenia 10 points in Slovakia and an impressive 20 percentage points in Poland. Banks in the Czech Republic have made the best progress, increasing the net recovery rate from 20.9 per cent in 2010 to 65.0 per cent in 2013, and also reducing the time for recovery from 6.5 to 2.1 years This radical improvement was achieved through a change in the distraint law which provides for a more efficient seizure of assets from debtors. and reversed the situation of debtors versus borrowers essentially. Overall, in spite of slight improvements in recovery rates in the CE region, managing NPLs is a costly process that consumes time and resources, as legal structures significantly differ between all CE countries. Therefore, banks should consider carefully before deciding to retain their NPLs in-house.

Banks would naturally like to avoid having to report immediate losses by selling loans at a price below their carrying amount in the balance sheet, and this is a reason why they tend to delay any decision about to dispose of their NPLs. Hence, banks tend to adjourn facing the existing problems, resort to repetitive restructuring („ever-greening") and remain waiting for a better future. Still, dealing with NPLs on the balance sheet – in addition to the already expounded capital trapping – consumes extensive resources from the whole banking organization (sometimes – due to the vigorous clamp on operating expenses – even to the detriment of sales and front office forces) and distracts substantial management time. However portfolio transactions can be a prompt and effective solution for restoring banks to financial health, especially if the pricing gap between banks and NPL investors is reduced by additional provisions made as a result of the AQR.

Recent evolution of key NPL metrics

Figure 5. Evolution of key NPL metrics, 2011 – Q4 2014



Source: Local national banks, EIU
Notes: Bubble size: Q4 2013 NPL volume (EURmn) Slovenia is not presented in the chart as NPL volumes declined by 28% due to significant write-downs and transfers to BAMC.

Despite improvements in real GDP, there has been limited or no reduction in NPL ratios and volumes. These have deteriorated further, although the pace of deterioration has been decelerating.

The nine countries can be divided into two groups. In three countries, Poland, Czech Republic and Slovakia, NPL ratios are lower than in the other six; and their NPL ratios and volumes have been stable or even showed some improvement. In the other six countries NPL ratios are substantially higher, and both NPL ratios and volumes are not improving. There was a slight reduction in the ratios in in Hungary (attributable to vigorous portfolio cleaning) and Bulgaria in Q4 2014. There was also a substantial reduction in the ratio in Slovenia in the same quarter, but this was attributable to the transfer of non-performing corporate loans to the state-owned 'bad bank', the Bank Asset Management Company (BAMC).

Excluding these corporate NPL transfers to BAMC in Slovenia, overall NPL volume in the six under-performing countries increased by about € 3.5bn in 2013. In all nine countries, the total amount of NPLs volume is €60bn, providing a large potential market for distressed debt sales. The total of €60bn is made up of corporate and retail NPLs in a proportion of about 2:1 which is also due to larger ticket size of corporate loans. The proportion of retail NPL volumes is higher in Poland, the Czech Republic, Slovakia and Hungary, while in the other five countries corporate NPL volumes dominate.

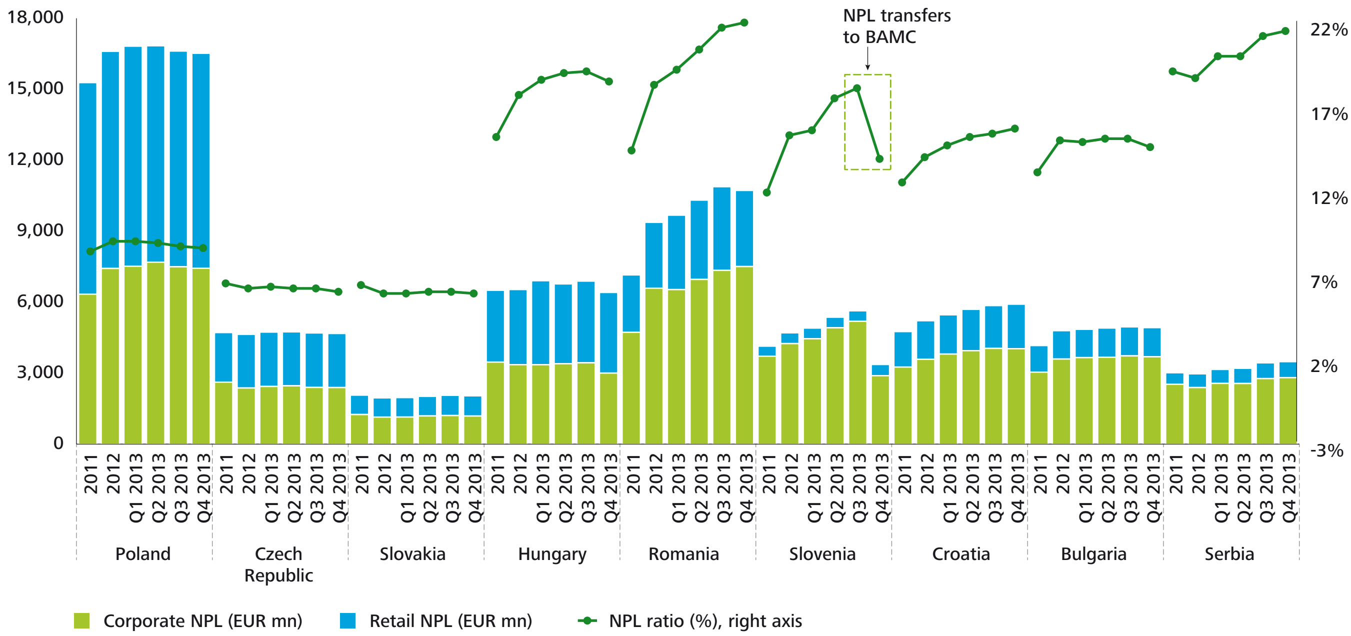
To cascade down the NPL landscape to individual banks` level, Figure 7 gives an overview of the portfolio quality and profitability of the top ten banks in each the nine countries in the study.

Table 1. NPL volumes and ratios, Q4 2013

EUR mn	Corporate	Corporate (%)	Retail	Retail (%)	Total	Total (%)
Poland	7,433	11.5%	9,086	7.1%	16,519	8.5%
Czech Republic	2,393	7.1%	2,285	5.0%	4,678	5.9%
Slovakia	1,189	8.1%	854	4.2%	2,043	5.8%
Hungary	3,004	17.9%	3,408	18.8%	6,412	18.4%
Romania	7,507	29.1%	3,216	13.7%	10,724	21.9%
Slovenia	2,895	20.4%	473	5.3%	3,368	13.8%
Croatia	4,036	28.1%	1,880	11.1%	5,916	15.6%
Bulgaria	3,695	19.3%	1,230	13.3%	4,925	14.5%
Serbia	2,812	27.3%	675	11.2%	3,487	21.4%
Total	34,965		23,106		58,072	

Source: National banks, Deloitte analysis

Figure 6. Evolution of key NPL metrics, 2011 – Q4 2014



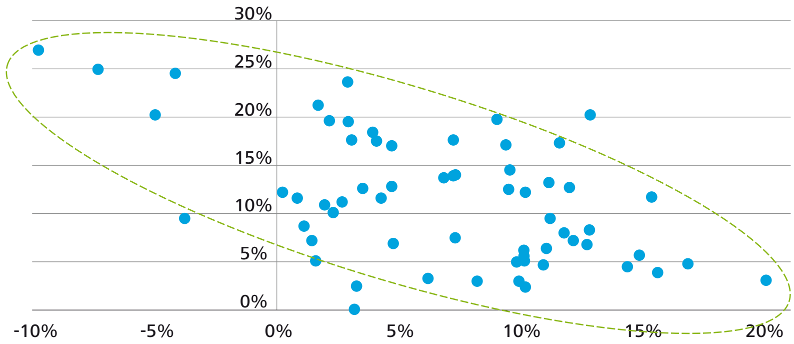
Source: National Banks, Deloitte analysis

Figure 7 shows that for most banks NPL ratios are high and this exerts a downward pressure on ROEs. Amongst the banks where a NPL ratio was available, 63 per cent have an NPL ratio above ten per cent and for 40 per cent it exceeds 15 per cent. Before the financial crisis NPL ratios and central bank targets were around five per cent. This indicates that there is much room for improvement. If we exclude the healthier Poland, Czech Republic and Slovakia and examine only the remaining, more contaminated six countries the figures are even worse: 85 per cent of banks have NPL ratios above 10 per cent and for 58 per cent the ratio exceeds 15 per cent. The median NPL ratio for the nine countries is 12.7 per cent, and 17.0 per cent for the six weaker performers. These high NPL ratios fundamentally and profoundly impede the return to healthy lending and economic growth, therefore have to be tackled and dismantled.

It is clear that the banking sector in most CE countries has amassed a substantial amount of NPLs; however the decision by a bank to enter the debt sales market will depend on its own financial circumstances. Figure 8 shows data for NPLs and ROE for the largest banking groups in the nine countries and illuminates the magnitude of NPL stocks they are tackling with.

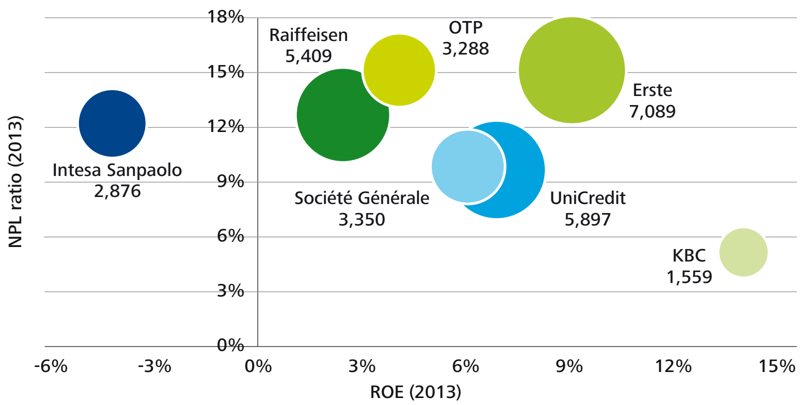
Irrespective of size and the fact that rapid business expansion is likely to result in a poorer quality of loan portfolio, KBC appears to achieve the best performance, with the highest ROE and the lowest NPL ratio. The most room for development might be for Intesa Sanpaolo, where the NPL ratio is above 12 per cent, while ROE is negative. However it would appear that the performance of each bank depends mainly on their main country or countries of operation. For example, the relatively strong performance of KBC could be explained by the fact that most of its assets are in the Czech Republic where NPL ratios are low and ROE is high. Similarly, Intesa's poor performance is attributable to subsidiary CIB in Hungary, where extensive project finance lending before the crisis and a high bank tax resulted in immense recurring losses for the bank. The tables below show how the approximate €30 billion NPL volumes break down and how NPL ratios vary between national subsidiaries of each of the seven largest banking groups. The volume of NPLs exceeds €1 billion in nine subsidiaries: four in Hungary, two in each of in Romania and Croatia, and one in Poland. However the large volume of NPLs in Intesa's Polish subsidiary Pekao is attributable to its large size rather than a high NPL ratio.

Figure 7. NPL ratio and ROE, top ten banks in the nine countries



Source: Banks' data disclosure, National banks, ECB CBD, ISI Emerging Markets
Note: Banks with NPL ratio above 30% or ROE below -10% were not displayed due to illustrative reasons. These rules exluded 13 banks of which 7 are Slovene, mainly due to ROEs deep below -10%. NPL data was not available for 15 additional banks, thus 62 banks are displayed in the chart.

Figure 8. NPL ratio, ROE and NPL volumes of leading bank groups in CE (EUR million)



Source: Banks' data disclosure, CNB, ECB CBD, ISI Emerging Markets, Deloitte analysis
Notes: Bubble size: Q4 2013 NPL volume (EURmn)

Table 2. NPL ratios and volumes in subsidiaries of major banking groups in CE

UniCredit subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
PL	Pekao	26,084	7.1%	1,852
CR	Zagrebacka Banka	10,202	18.3%	1,867
CZ	UniCredit CZ & SK	11,114	3.2%	356
BG	UniCredit Bulbank	4,764	17.0%	810
RO	Unicredit Tiriac	4,266	11.1%	474
HU	UniCredit Bank Hungary	3,376	n/a	n/a
SI	UniCredit Banka	2,070	17.0%	352
SRB	UniCredit Banka	1,357	13.8%	187
	Total	**63,232**	**9.9%**	**5,897**

Société Générale subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
CZ	Komerční Banka	18,204	3.8%	692
RO	BRD	7,613	24.8%	1,888
CR	Splitska Banka	2,519	12.1%	305
PL	Eurobank	2,278	n/a	n/a
SI	SKB Banka	2,180	6.8%	148
SRB	Société Générale Banka	1,425	9.4%	134
BG	Soc. Gén. Expressbank	1,444	12.7%	183
	Total	**35,661**	**10.0%**	**3,350**

Erste Group subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
CZ	Ceska Sporitelna	17,023	4.7%	800
RO	BCR	9,549	30.6%	2,922
SK	Slovenska Sporitelna	6,990	5.6%	391
CR	Erste & Steiermärkische	6,978	21.1%	1,472
HU	Erste Bank Hungary	5,287	26.8%	1,417
SRB	Erste Bank	562	15.3%	86
	Total	**46,389**	**15.3%**	**7,089**

OTP Group subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
HU	OTP Hungary	10,115	17.4%	1,760
BG	DSK Bank	3,793	20.1%	762
HU	OTP Jelzálogbank	3,857	6.1%	235
CR	Otp Banka Hrvatska	1,264	12.5%	158
RO	OTP Bank Romania	1,358	17.8%	242
SK	OTP Banka Slovensko	1,132	11.5%	130
	Total	**21,519**	**15.3%**	**3,288**

Erste Group subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
CZ	CSOB Group	18,833	3.0%	565
HU	K&H	5,102	12.1%	617
SK	Ceskoslovenska Obchodna	4,360	4.9%	214
BG	Cibank JSC	686	23.8%	163
	Total	**28,981**	**5.4%**	**1,559**

Intesa subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
SK	VUB	7,611	2.9%	221
CR	Privredna Banka Zagreb	6,422	7.4%	475
HU	CIB	4,232	37.3%	1,579
SRB	Banca Intesa	2,332	12.4%	289
SI	Banka Koper	1,795	8.6%	154
RO	Intesa Sanpaolo România	823	19.2%	158
	Total	**23,215**	**12.4%**	**2,876**

Raiffeisen subsidiaries in CE (2013, EUR mn)

	Bank name	Loans	NPL%	NPL vol.
PL	Raiffeisen Bank Polska	9,744	10.0%	974
SK	Tatra Banka	6,879	5.0%	344
CZ	Raiffeisen Bank	5,983	6.8%	407
HU	Raiffeisen Bank	4,990	29.7%	1,482
RO	Raiffeisen Bank	4,266	11.6%	495
CR	Raiffeisenbank Austria	3,436	13.9%	478
BG	Raiffeisen Bank	2,526	20.1%	508
SRB	Raiffeisen Banka	1,105	13.1%	145
SI	Raiffeisen Banka	1,051	28.3%	298
	Total	**42,120**	**12.8%**	**5,409**

Recent transaction activity

NPL transaction activity in CE has perked up recently, due to increasing investor appetite and a greater willingness by banks to supply NPLs to the market. Recent transaction activity has also included mortgage and corporate loan portfolios, in addition to more frequent consumer portfolio transactions, and there has been transaction activity in some countries where there has been very limited in the past.

The non-comprehensive table below highlights selected landmark transactions. Regarding future expectations, due to the factors articulated above, a number of transactions are to follow.

Table 3. Selected recent NPL transactions

Date	Country	Seller	Buyer	Type of portfolio	PL or NPL?	Portfolio size (EUR mn)	Approx. price (EUR mn)	Deloitte involvement	Consummated?
Sep-14	Romania	Bank of Cyprus	Confidential	Corporate	NPL	Confidential	95	Sell side legal advisor	Yes
Aug-14	Romania	MKB	APS	Corporate Recovery Management S.A. (Corporate)	NPL	85*	Confidential	Sell side financial advisor	Yes
Aug-14	Romania	RBS	UniCredit	Corporate business	PL, NPL	260 (assets)	Confidential		Yes
Aug-14	Adria region	HAA	B2Holding	Mortgage, consumer	NPL	169	Confidential	Buy side financial advisor	Yes
Jul-14	Romania	Volksbank	DB, AnaCap, H.I.G Capital, APS	Mortgage (84%) and corporate (16%) loans	NPL	495	Confidential		Yes
Jul-14	Romania	BCR	DB, APS	Corporate	NPL	250	Confidential		Yes
Jul-14	Poland	Confidential	Confidential	Corporate, mortgage, consumer	PL, NPL	93	Confidential	Buy side financial advisor	Confidential
Apr-13	Romania	RBS	UniCredit	Retail business	PL, NPL	315 (assets)	Confidential		Yes
Mar-13	Hungary	Credigen Bank	Budapest Bank	Consumer loans	PL	Conf. (16 th clients)	Confidential	Sell side financial advisor	Yes
Mar-13	Romania	Citibank	Raiffeisen Bank	Consumer business	PL, NPL	90	Confidential		Yes

*Gross client receivables as of 31 Dec 2013

Poland

In 2013, economic conditions in Poland slightly deteriorated. The annual growth in real GDP decreased from 2.1 per cent in 2012 to 1.5 per cent, largely due to sluggish external and internal demand. The rate of inflation fell by 2.6 percentage points, whilst unemployment and the budget deficit both increased by 0.7 percentage points. This slow-down is expected to be short-lived though and the growth rate in real GDP is forecast to recover to 2.7 per cent in 2014.

Both retail and corporate lending grew slightly, by 4.1 per cent and 2.2 per cent, respectively. The volume of retail NPLs fell slightly by one per cent in 2013 while corporate NPL volumes levelled off. The NPL ratios for retail and corporate loans both receded slightly, on the back of a strong economy and an active debt purchase market.

The average CAR for Polish banks increased to 15.8 per cent, indicating robust capital adequacy, but this is still the third lowest CAR among the nine countries in the study, higher only than the 11.8 per cent in Slovenia and 15.0 per cent in Romania. Although both ROE and ROA decreased in 2013, they are still higher than in the other countries with the exception of the Czech Republic. The cost/income ratio rose by two percentage points to 52.9 per cent, a healthy level. The loans/deposits ratio fell by 1.5 points to 106.9 per cent, which means that the banking sector has not yet achieved self-financing. FX share of lending diminished by 2.0 percentage points from a comparably low level of 32.0 per cent, implying no significant FX risk in international comparison.

Table 4. Key metrics in Poland

Macro	2012	2013	Change (% point)
GDP (% real change pa)	2.1%	1.5%	-0.6%
Consumer prices (% change pa)	3.7%	1.1%	-2.6%
Recorded unemployment (%)	12.8%	13.5%	0.7%
Budget balance (% of GDP)	-1.9%	-2.6%	-0.7%
Public debt (% of GDP)	48.3%	49.8%	1.5%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (PLN mn)	531,397	553,336	4.1%
Corporate loans (PLN mn)	272,105	277,958	2.2%
NPL volumes			
Retail NPLs (PLN mn)	39,452	39,071	-1.0%
Corporate NPLs (PLN mn)	31,932	31,960	0.1%
NPL ratios			
Retail NPL ratio (%)	7.4%	7.1%	-0.4%
Corporate NPL ratio (%)	11.7%	11.5%	-0.2%
Key ratios			
CAR (%)	14.7%	15.8%	1.1%
ROE (%)	11.2%	10.2%	-1.0%
ROA (%)	1.2%	1.1%	-0.1%
CIR (%)	50.9%	52.9%	2.0%
L/D (%)	108.3%	106.9%	-1.5%
FX share of lending (%)	32.0%	30.0%	-2.0%

Source: EIU, NBH, ECB CBD

The NPL ratios for retail and corporate loans both receded slightly, on the back of a strong economy and an active debt purchase market.

The top banks in Poland seem to be in good shape, with reasonable profitability and portfolio quality. Only three banks, Getin Noble, BGK and Raiffeisen, have NPL ratios of10 per cent or higher. The low NPL ratios of Millennium and ING (2.9 per cent and 4.6 per cent respectively) indicate good loan portfolio quality. The average NPL ratio for the banking sector in Poland is 8.5 per cent, which is the third-lowest among the nine countries, behind Slovakia and the Czech Republic. Asset concentration is less of an issue in the Polish banking system as it is in the other eight countries, with top three banks holding 32 per cent of total banking assets, the top five 45 per cent and the top ten 62 per cent. (The corresponding averages for the nine countries in total are 42 per cent, 56 per cent and 76 per cent.) Equity concentration is less in Poland than the other CE countries. The top three banks represent 39 per cent of total banking equity in the country, the top five 51 per cent and the top ten 70 per cent, compared to the averages for the nine countries of 47 per cent, 60 per cent and 80 per cent. Although the concentration of assets and equity is still limited, a significant amount of market consolidation has occurred in recent years. PKO acquired Nordea's Polish operations; BZ WBK has merged with Kredyt Bank (previously owned by KBC) and is acquiring 60 per cent of Santander Consumer Bank; and Raiffeisen acquired 70 per cent of Polbank. Late 2013 also saw some consolidation among the banks outside the top ten, with the acquisition of BGZ (owned by Rabobank) by BNP Paribas. Further consolidation is likely but the takeover targets will probably be limited to smaller banks, with the PFSA signalling that it will oppose further concentration among the top players. As a result, state-owned PKO retains its leading position with a 13.7 per cent market share, followed by Pekao (10.8 per cent) owned by UniCredit, and Santander-owned BZ WBK (7.2 per cent). Poland is the only one of the nine countries in the survey where all top five banks have ROE over 10 per cent and ROA over one per cent. Additionally, only Poland and the Czech Republic can boast that all their top 10 banks are profitable. As the table presents, in the top 10 there are two state owned banks and one in Leszek Czarnecki`s private ownership, all other banks are possessed by foreign owners.

Table 5. Top players in the Polish banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	PKO	47,800	6,112	781	1.6%	12.8%	8.2%	State
2	Pekao	37,815	5,561	674	1.8%	12.1%	7.1%	UniCredit
3	BZ WBK	25,171	3,304	388	1.5%	11.7%	7.9%	Santander
4	mBank	24,412	2,331	257	1.1%	11.0%	6.3%	Commerzbank
5	ING BSK	20,378	2,028	221	1.1%	10.9%	4.6%	ING
6	Getin Noble	15,408	1,098	75	0.5%	6.8%	13.6%	Leszek Czarnecki
7	Millennium	13,767	1,212	120	0.9%	9.9%	2.9%	BCP
8	Raiffeisen	11,848	1,342	31	0.3%	2.3%	10.0%	Raiffeisen
9	Citibank	10,950	1,758	223	2.0%	12.7%	6.7%	Citibank
10	BGK	10,680	1,967	178	1.7%	9.0%	19.5%	State
	Banking sector total	**349,653**	**38,010**	**3,885**	**1.1%**	**10.2%**	**8.5%**	

Source: Banks' data disclosure, CNB, ECB CBD, ISI Emerging Markets

The debt sales market in Poland is by far the most active and developed among the nine countries in the study.

Kruk is the leading investor in the market, with a total of purchased and outsourced debt in excess of PLN 50bn in 2013 (EURPLN = 4.15 as of 31 December 2013). Ultimo (recently acquired by B2 Holding) purchased PLN 25bn debt but took on no outsourced debt for collection. GK Best, Casus Finanse, EGB Investments and Navi Group all transacted similar volumes, but GK Best and Navi Group were more active in debt purchases, whereas Casus Finanse and EGB Investments focused on outsourcing. The rest of the market (about 44 per cent of the total) was made up of many other smaller investors.

Key data for the Polish consumer debt sales market are shown in Table 6.

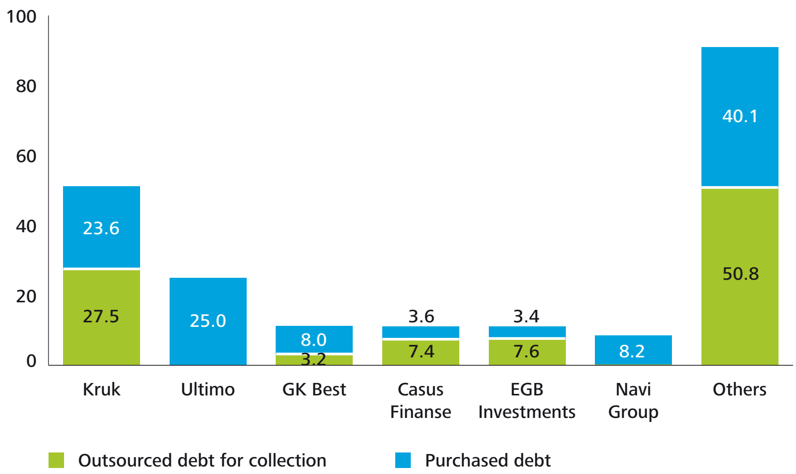
Portfolios with a nominal value of PLN 9.4bn were sold in 2013 at an average price of 11 per cent. This represents an increase of more than 25 per cent compared to 2012; however average prices fell by 3 percentage points, supposedly due to the increase in supply. As for the future, the predominance of local investors in the market should ensure gradually-rising demand for debt purchases over time. Growth in investment funds targeting purchased debt also creates incremental demand. Therefore with rising demand meeting stable supply, the price for consumer NPLs is expected to increase.

The corporate debt market is way less vivid, as both volumes and prices are substantially more compressed relative to the consumer debt market. In 2013 there was a fall of almost 50 per cent in the volumes offered for sale, and average prices also fell. The corporate debt market is more complex than the consumer market for several reasons:

- recoveries are less predictable and depend on specialised units;
- business analysis and valuations are needed;
- collateral valuations are needed;
- additional legal expertise is also required; and
- handling of the debtor (customer) differs markedly.

The market for mortgage debt is at a very early stage of development and is virtually non-existent. Although there have been a few transactions recently, sales of non-performing mortgage loans are not common due to low provisioning levels and resulting provisioning gaps.

Figure 9. Polish debt market, 2013 (nominal value, PLN bn)



Source: Kruk

Table 6. Polish consumer debt market

PLN bn	Portfolios offered for sale	Average prices
2013	9.4	11%
2012	7.4	14%

Source: Kruk

Table 7. Polish corporate debt market

PLN bn	Portfolios offered for sale	Average prices
2013	2.6	10%
2012	2.5	6%

Source: Kruk

Czech Republic

Following a contraction of 0.9 per cent in 2012, real GDP in the Czech Republic shrank by a further 0.9 per cent in 2013, due mainly to low investment and week contribution of net exports. Inflation declined by 1.9 percentage points, while unemployment and budget deficit both increased by 0.9 point.

There was an increase in both retail and corporate loans, of 4.3 per cent and 3.8 per cent, respectively.

The volume of retail and corporate NPL stocks both increased by 0.8 per cent. However, the NPL ratios for both receded slightly, to 5.0 per cent and 7.1 per cent respectively. The corporate NPL ratio is the lowest among the nine countries in the study, and the retail NPL ratio is the second-lowest, behind Slovakia. The Czech Republic is therefore in a relatively strong position, with low and falling NPL ratios. The problem of NPLs is therefore less acute here than in the other countries.

The average CAR for Czech banks increased to 17.3 per cent, indicating robust capital adequacy. Although both ROE and ROA fell in 2013, they are still mirroring the highest profitability among the countries in the study. Operating efficiency, measured by the cost/income ratio (43.0 per cent), is also the highest of all the countries. The loans/deposits ratio did not change significantly in 2013 and at 75.4 per cent is much the lowest among the nine countries, which is also a typical feature of the Czech banking market, making Czech subsidiaries even more precious for their mother banks in times of liquidity frictions. FX share of lending increased from 15 per cent to 18 per cent, however, due to a still fairly low level this is less of an issue.

The Czech banking sector performed well in 2013, with ROE of 13.7 per cent, ROA of 1.3 per cent and NPL ratio of 5.9 per cent. GE Money Bank (GEMB) has the highest NPL ratio (14.4 per cent), and the ratio for PPF Banka (9.4 per cent) is also high relative to the country average. It has to be noted though, that GEMB is focused on consumer lending and PPF mostly on corporate lending, whilst other banks run more universal activities. All of the top five banks have a NPL ratio under five per cent, reflecting an enviable portfolio quality. (The NPL ratio for Hypotechni Banka was 2.3 per cent in 2012, and although the annual report for 2013 was not yet available at the time of writing this report, it is expected to remain under 5 per cent though.) The performance of the top three banks is even better, with the ROE above 15 per cent for all of them and ROA above 1.5 per cent, with market leading CSOB tabling an impressive ROE of 20 per cent.

Table 8. Key metrics in the Czech Republic

Macro	2012	2013	Change (% point)
GDP (% real change pa)	-0.9%	-0.9%	0.0% ●
Consumer prices (% change pa)	3.3%	1.4%	-1.9% ●
Recorded unemployment (%)	6.8%	7.7%	0.9% ●
Budget balance (% of GDP)	-0.5%	-1.4%	-0.9% ●
Public debt (% of GDP)	46.2%	46.0%	-0.1% ●
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (CZK mn)	1,132,231	1,180,731	4.3% ●
Corporate loans (CZK mn)	835,415	867,135	3.8% ●
NPL volumes			
Retail NPLs (CZK mn)	58,688	59,179	0.8% ●
Corporate NPLs (CZK mn)	61,480	61,990	0.8% ●
NPL ratios			
Retail NPL ratio (%)	5.2%	5.0%	-0.2% ●
Corporate NPL ratio (%)	7.4%	7.1%	-0.2% ●
Key ratios			
CAR (%)	16.4%	17.3%	0.9% ●
ROE (%)	16.3%	13.7%	-2.6% ●
ROA (%)	1.4%	1.3%	-0.2% ●
CIR (%)	43.9%	43.0%	-0.9% ●
L/D (%)	75.1%	75.4%	0.4% ●
FX share of lending (%)	15.0%	18.0%	3.0% ●

Source: EIU, NBH, ECB CBD

The Czech Republic is therefore in a relatively strong position, with low and falling NPL ratios. The problem of NPLs is therefore less acute here than in the other countries.

Asset concentration is quite high: the top three and top five Czech banks account for 51 per cent and 63 per cent of total assets respectively, compared with averages of 42 per cent and 56 per cent for all the countries in the study. However, asset concentration among the top ten banks is similar to the average for the nine countries. Equity concentration however is the highest of any of the countries among the country's top three banks (55 per cent) and top five (73 per cent), and the second-highest among the top 10 (88 per cent) behind Hungary. The averages for the nine countries are 47 per cent, 60 per cent and 80 per cent respectively. CSOB (owned by KBC), Ceska Sporitelna (Erste) and Komercni Banka (Société Générale) are the market leaders with market shares of 18.5 per cent, 17.2 per cent and 15.5cent. There is a significant difference between the third and fourth players as the market share of the fourth-largest bank, UniCredit CZ & SK, is only 7.2 per cent. Nine of the top ten banks are foreign-owned: only PPF Banka controlled by Petr Kellner, is in Czech ownership.

Participants in the debt sales market appear to deal with the Czech Republic and Slovakia together as the markets in the two countries have similar characteristics.

The size of the Czech and Slovak consumer debt market is smaller than in Poland and Romania, as both NPL ratios and volumes are substantially lower. A distinctive feature of the market however is the high average prices for consumer portfolios, which are attributable to the limited supply and high achievable recovery rates.

The Czech debt purchase market consists mainly of consumer loans, (about 90 per cent of the total market). Transactions involving mortgages are limited, as banks do not have a real incentive to dispose of this type of loan. Corporate loans are usually sold off-trade to a pre-selected group of investors, without an open tender. A unique characteristic of the Czech Republic is that substantially more NPL transactions are in the form of outsourcing debt collection rather than assets sales, with a proportion of about 2:1.As per competition, the market is fragmented, however Kruk and Best outstand in the market with approximately 25 per cent and 20 per cent market shares, respectively. About 20 per cent of the market consists of other 25 AIA members (the Association of the Collection Agencies in the Czech Republic) and around 35 per cent of the market is made up of advocates and other small companies.

Table 9. Top players in the Czech banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	CSOB	33,724	2,615	523	1.6%	20.0%	3.0%	KBC
2	Ceska Sporitelna	31,356	3,523	592	1.9%	16.8%	4.7%	Erste
3	Komercní Banka	28,352	3,064	477	1.7%	15.6%	3.8%	Société Générale
4	UniCredit CZ & SK	13,103	1,859	115	0.9%	6.2%	3.2%	UniCredit
5	Hypotechni Banka	7,839	1,023	104	1.3%	10.2%	2.3%*	KBC
6	Raiffeisen Bank	7,207	692	33	0.5%	4.8%	6.8%	Raiffeisen
7	Ceskomoravska Stavebni	6,067	365	50	0.8%	13.7%	n/a	KBC
8	ING Bank	5,013	FB	8	0.2%	n/a	n/a	ING
9	GE Money Bank	4,974	1,365	130	2.6%	9.5%	14.4%	GE Capital
10	PPF Banka	3,840	188	21	0.5%	11.2%	9.4%	PPF Group
	Banking sector total	**182,637**	**16,620**	**2,284**	**1.3%**	**13.7%**	**5.9%**	

* 2012 data
Source: Banks' data disclosure, CNB, ECB CBD, ISI Emerging Markets
FB: foreign branch

Table 10. Consumer debt market in Czech Republic and Slovakia

PLN bn	Portfolios offered for sale	Average prices
2013	1.5	21%
2012	1.8	19%

Source: Kruk

Slovakia

Real GDP growth halved to 0.9 per cent in 2013, principally on the back of decreasing investments and a trimmed positive contribution of net exports. Stemming from dampened growth, inflation declined by 2.2 percentage points and in alignment with weaker economic performance, unemployment augmented by 0.5 percentage point. Nevertheless, budget deficit was reduced by 1.7 percentage point and thus were reined under the 3 per cent Maastricht criterion.

The amount of retail loans increased by 9.5 per cent, whereas corporate loans contracted slightly. Both retail and corporate NPL volumes increased to more than €2 billion in total. However the NPL ratio for retail loans, already the lowest among the nine countries in the study, dwindled by a further 0.2 points to 4.2 per cent. Portfolio quality deterioration could not be arrested in the corporate segment though, as corporate NPL ratio increased by 0.5 percentage point to 8.1 per cent, however, this is still the second lowest value amid the nine countries.

The capital adequacy ratio increased by 0.6 point to 16.6 per cent, and now equals to the average for the nine countries in the study. The ROA remained at 0.9 per cent, whereas ROE increased slightly to 7.9 per cent, the third highest value amongst the nine.

The loans/deposits ratio increased slightly to 94.7 per cent, still mirroring the healthy characteristic of a self-funding banking sector. The FX share of total lending is not a serious issue, with the euro as the national currency.

Table 11. Key metrics in Slovakia

Macro	2012	2013	Change (% point)
GDP (% real change pa)	1.8%	0.9%	-0.9%
Consumer prices (% change pa)	3.6%	1.4%	-2.2%
Recorded unemployment (%)	13.6%	14.1%	0.5%
Budget balance (% of GDP)	-4.5%	-2.8%	1.7%
Public debt (% of GDP)	52.7%	55.4%	2.8%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (EUR mn)	18,757	20,534	9.5%
Corporate loans (EUR mn)	15,000	14,612	-2.6%
NPL volumes			
Retail NPLs (EUR mn)	812	854	5.2%
Corporate NPLs (EUR mn)	1,144	1,189	3.9%
NPL ratios			
Retail NPL ratio (%)	4.3%	4.2%	-0.2%
Corporate NPL ratio (%)	7.6%	8.1%	0.5%
Key ratios			
CAR (%)	16.0%	16.6%	0.6%
ROE (%)	7.7%	7.9%	0.2%
ROA (%)	0.9%	0.9%	0.1%
CIR (%)	61.0%	56.0%	-5.0%
L/D (%)	92.3%	94.7%	2.4%
FX share of lending (%)	1.4%	1.0%	-0.4%

Source: EIU, NBH, ECB CBD

Real GDP growth halved to 0.9 per cent in 2013, principally on the back of decreasing investments and a trimmed positive contribution of net exports.

With the lowest NPL ratio (5.8 per cent) amongst the nine countries, asset quality in the Slovak banking sector is high. However, there is room for improvement in profitability and although the average ROE (7.9 per cent) is the third-highest of the nine countries, it is not a satisfactory equity return. Among the top ten banks, OTP Banka has the highest NPL ratio with 11.5 per cent, and the ratio for Sberbank (10.8 per cent) of Sberbank is also high. In contrast, VUB has an excellent low NPL ratio of 2.9 per cent. Four banks in the top ten achieved a ROE above ten per cent and a ROA equal to or above one per cent. Prima Banka, owned by Penta, is the only loss-making bank in the top 10. Asset concentration is higher in Slovakia than in any of the other countries: the top three, five and ten banks stand hold 56 per cent, 72 per cent and 92 per cent of the total assets of the banking sector respectively. Equity concentration is lower: the top three, five and ten banks account for 51 per cent, 61 per cent and 77 per cent of total equity. This compares with an average of 47 per cent the top three, 61 per cent for the top 5, and 80 per cent for the top ten banks in all nine countries in the study. Slovenska Sporitelna (owned by Erste), VUB (Intesa) and Tatra Banka (Raiffeisen) are the largest banks, with market shares of 20.1 per cent, 19.2 per cent and 16.3 per cent. The market share of the fourth-largest bank, Ceskoslovenska Obchodna (KBC), is only 9.6 per cent. Nine of the top ten banks are foreign-owned. There is no state-owned bank in the top ten, and only one bank is in Slovak private ownership, Postova Banka, acquired in 2013 by J&T Finance (controlled by Jozef and Patrik Tkac) from Istrokapital SE.

Participants in the debt sales market appear to deal with the Czech Republic and Slovakia together as the markets in the two countries have similar characteristics.

The size of the Slovak and Czech consumer debt market is smaller than in Poland and Romania, as both NPL ratios and volumes are substantially lower. A distinctive feature of the market however is the high average prices for consumer portfolios, which are attributable to the limited supply of NPLs and high achievable recovery rates.

Table 12. Top players in the Slovak banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	Slovenska Sporitelna	11,776	1,262	187	1.6%	14.8%	5.6%	Erste
2	VUB	11,260	1,282	105	0.9%	8.2%	2.9%	Intesa Sanpaolo
3	Tatra Banka	9,543	988	100	1.0%	10.1%	5.0%	Raiffeisen
4	Ceskoslovenska Obchodna	5,611	642	63	1.1%	9.8%	4.9%	KBC
5	UniCredit CZ & SK*	3,944	n/a	n/a	n/a	n/a	n/a	UniCredit
6	Postova Banka	3,881	468	67	1.7%	14.3%	4.4%	J&T Finance
7	Prva Stavebna Sporitelna	2,438	247	25	1.0%	10.1%	5.5%	Schwäbisch Hall
8	Sberbank Slovensko	2,050	204	4	0.2%	2.0%	10.8%	Sberbank
9	Prima Banka Slovensko	1,919	103	-6	-0.3%	-5.8%	n/a	Penta Investments
10	OTP Banka Slovensko	1,417	90	4	0.3%	4.3%	11.5%	OTP
	Banking sector total	**58,513**	**6,900**	**549**	**0.9%**	**7.9%**	**5.8%**	

*UniCredit SK was merged into UniCredit CZ, thus it performs banking activities as a foreign branch now
Source: Banks' data disclosure, NBS, ECB CBD, ISI Emerging Markets

Table 13. Consumer debt market in Czech Republic and Slovakia

PLN bn	Portfolios offered for sale	Average prices
2013	1.5	21%
2012	1.8	19%

Source: Kruk

With the lowest NPL ratio (5.8 per cent) amongst the nine countries, asset quality in the Slovak banking sector is high.

Hungary

The economy improved in Hungary in 2013, with an increase of 1.1 per cent in real GDP, compared to a fall of 1.7 per cent the previous year. The turnaround derived mainly from growth in domestic demand, which was boosted by fiscal measures and significant monetary easing. The sharp fall in inflation by 3.9 points to 1.7 per cent was attributable mainly to reductions in regulated energy and utility prices. Unemployment shed 1.6 points arriving to 9.1 per cent, which is the second-lowest level among the nine countries in the study, behind Romania. The budget deficit increased slightly to 2.3 per cent, still below the Maastricht limit of three per cent. Although public debt as a percentage of GDP melted slightly to 79.2 per cent, this is still by far the highest level among the nine countries.

The volume of retail loans fell by a considerable 7.1 per cent, due to a contraction in existing mortgage portfolios and shortage of fresh mortgage loans. Although this is less than the half the rate of shrinkage in 2012 (15.9 per cent), retail loan volumes in 2012 were affected by the early FX mortgage repayment scheme, which exerted a huge downward pressure on retail loan volumes. Corporate loan volumes also diminished, by 4.9 per cent which is about half the rate of contraction experienced in 2012, due to the effect of the government's funding for growth scheme which is intended to provide cheap funding for SMEs.

Retail NPL volumes increased by 7.3 per cent in 2013, almost reaching HUF1bn. The increase is attributable to a rise of 2.5 percentage points in the NPL ratio for retail loans, as expectations about the government's solutions to the FX debt problem resulted in reduced willingness by borrowers to repay. Corporate NPL volumes fell substantially in 2013, by 10.6 per cent. A reduction in the corporate NPL ratio of 1.1 points to 17.9 per cent was attributable largely to vigorous portfolio cleaning. Portfolio cleaning reached record levels, however non-performing loans outstanding would not have increased further without cleaning as well.

The capital adequacy ratio gained by 1.7 points to 17.4 per cent, the third highest among the nine countries in the study. This indicates a strong loss-absorption capacity. Profitability improved markedly in 2013, with ROE and ROA moving from negative to positive. ROE improved by 8.3 points to 2.2 per cent. ROA improved by 0.7 points to 0.2 per cent, which is very low although it is the fifth highest among the nine countries.

Table 14. Key metrics in Hungary

Macro	2012	2013	Change (% point)
GDP (% real change pa)	-1.7%	1.1%	2.8% 🟢
Consumer prices (% change pa)	5.7%	1.7%	-3.9% 🟢
Recorded unemployment (%)	10.7%	9.1%	-1.6% 🟢
Budget balance (% of GDP)	-2.2%	-2.3%	-0.2% 🔴
Public debt (% of GDP)	79.8%	79.2%	-0.6% 🟢
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (HUF bn)	5,687	5,285	-7.1% 🔴
Corporate loans (HUF bn)	5,157	4,905	-4.9% 🔴
NPL volumes			
Retail NPLs (HUF bn)	927	995	7.3% 🟢
Corporate NPLs (HUF bn)	981	877	-10.6% 🟢
NPL ratios			
Retail NPL ratio (%)	16.3%	18.8%	2.5% 🔴
Corporate NPL ratio (%)	19.0%	17.9%	-1.1% 🟢
Key ratios			
CAR (%)	15.7%	17.4%	1.7% 🟢
ROE (%)	-6.1%	2.2%	8.3% 🟢
ROA (%)	-0.5%	0.2%	0.7% 🟢
CIR (%)	79.7%	65.9%	-13.9% 🟢
L/D (%)	119.3%	114.2%	-5.1% 🟢
FX share of lending (%)	55.0%	51.0%	-4.0% 🟢

Source: EIU, NBH, ECB CBD

However there were significant one-off items which distorted the reported profitability of the sector: these include intra-group debt forgiveness of about HUF120 bn by Bayern LB to MKB. Excluding this one-off item, the pre-tax profit of the banking sector would have been around zero. A decline in the cost/income ratio by 13.9 points to 65.9 per cent, indicating improved operating efficiency, is consistent with the improvements in ROE and ROA. The loans/deposits ratio decreased by 5.1 points to 114.2 per cent which was one of the highest among the nine countries, equal with Poland and exceeded only by Slovenia. The FX share of lending was still on the wane, decreasing to 51 per cent in 2013 and implying attenuating, but still fairly high FX risks.

The Hungarian banking sector is afflicted by high NPL ratios and entailing low profitability. Four leading banks have NPL ratios around or above 25 per cent, and for CIB it is a woeful 37.3 per cent. The NPL ratio for market leader OTP is 17.4 per cent, while for K&H it is 12.1 per cent. The figures for MKB are distorted by the HUF120 bn intra-group debt forgiveness from Bayern LB, mentioned earlier. There are wide variations in profitability between the top banks in 2013. CIB, Raiffeisen, MKB and Erste are heavily loss-making; OTP made a relatively large profit with a low ROE though; whereas K&H, UniCredit and Budapest bank achieved limited profits. CIB and Raiffeisen ended a shocking year in 2013 by losing 76.7 per cent and 49.5 per cent of their equity respectively. Asset concentration among the top banks in Hungary is close to the median level for the nine countries as a whole. The top three, five and ten banks account for 39 per cent, 52 per cent and 76 per cent of banking assets respectively. The corresponding proportions for equity concentration are 54 per cent, 63 per cent and 89 per cent among the top three, five and ten banks. These are well above the corresponding average figures for the nine countries: the proportion is the second-highest value for the top three banks and the highest for the top ten banks among all the nine countries. OTP continues being the market leader with a market share of 22.8 per cent, followed by K&H (KBC) and Erste with 8.8 per cent and 7.8 per cent respectively. A number of the top banks have domestic ownership. Although various private and corporate entities have equity ownership in OTP, decision-making for the bank is in Hungary. Magyar Fejlesztési Bank is state-owned and in July 2014 the state acquired MKB from Bayern LB.

Table 15. Top players in the Hungarian banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	OTP	22,693	3,995	163	0.7%	4.1%	17.4%	Private & corp. entities
2	K&H	8,752	649	66	0.8%	10.2%	12.1%	KBC
3	Erste	7,805	606	-59	-0.8%	-9.7%	26.8%	Erste
4	MKB	6,446	507	-21	-0.3%	-4.1%	24.4%	BayernLB (HU state from Jul 14)
5	Raiffeisen	6,351	351	-174	-2.7%	-49.5%	29.7%	Raiffeisen
6	CIB	6,290	575	-441	-7.0%	-76.7%	37.3%	Intesa Sanpaolo
7	UniCredit	6,020	693	22	0.4%	3.2%	n/a	UniCredit
8	OTP Jelzálogbank	4,326	188	19	0.4%	10.1%	6.1%	OTP
9	Magyar Fejlesztési Bank	3,762	690	8	0.2%	1.2%	n/a	State
10	Budapest Bank	3,005	446	33	1.1%	7.4%	n/a	GE Capital
	Banking sector total	**99,493**	**9,730**	**215**	**0.2%**	**2.2%**	**18.4%**	

Source: Banks' data disclosure, NBH, ECB CBD, ISI Emerging Markets

The Hungarian banking sector is afflicted by high NPL ratios and entailing low profitability. Four leading banks have NPL ratios around or above 25 per cent.

Table 16. Not problem-free retail receivables sold

	Mortgage					Consumer					Retail debt sales market		
EUR mn	Total gross exposure	Gross value sold	% sold	Net value %	Selling price %	Total gross exposure	Gross value sold	% sold	Net value %	Selling price %	Total volume	o/w mortgage	o/w consumer
2012	15,105	158	1.0%	63%	54%	3,727	240	6.4%	27%	15%	398	40%	60%
2013	12,718	227	1.8%	67%	53%	3,407	246	7.2%	18%	12%	472	48%	52%

Source: NBH

Another significant development in 2013 was the integration of several cooperative credit institutions under their umbrella bank, Magyar Takarékszövetkezeti Bank (MTB). The total assets of MTB at 31 December 2013 were about €1.6bn, compared to assets of the cooperative credit institution sector of about €5.7 bn. Therefore, a strong integration was established under MTB which is expected to play a markedly more significant role in the Hungarian credit intermediation market in the future.

In preparation for the AQR, Hungarian banks cleaned up their loan portfolios, mainly in the mortgage segment.

The gross value of sold not problem-free mortgage loans was €158mn in 2012, which surged by more than 40 per cent in 2013 to €227mn in 2013. However banks` propensity to sell was still anaemic, as sales in 2013 amounted to only 1.8 per cent of their 2012 year-end total gross exposure. Average selling prices were quite high though, 53 per cent in 2013 and 54 per cent in 2012. As for not problem-free consumer loans, gross value sold was practically the same in 2012 and 2013 around EUR 240 mn, but propensity to sell was notably higher compared to the mortgage segment and surpassed 7 per cent in 2013. Average selling prices dwindled to 12 per cent in 2013 from 15 per cent in 2012.

With the upturn in the distressed mortgage debt sales market in 2013, the Hungarian not problem-free retail debt sales market was composed of mortgage and consumer loans in a practically equal proportion as of year-end 2013. The corporate debt sales market is quasi non-existent. At the same time, it has to be noted that the above described market activity was made up of many smaller transactions and even transfers within financial groups (e.g. market leading OTP`s transfers to its own debt collection entity).

The corporate debt market is expected to experience a stimulus in autumn 2014, as the envisaged "bad bank" to be established by the National Bank of Hungary is reported to begin buying distressed corporate debt from banks at market prices from October 2014. Banks would have the option to offer bad project finance debts above nominal value of HUF 500 mn and repossessed real estates above HUF 200 mn to NBH.

The corporate debt market is expected to experience a stimulus in autumn 2014, as the envisaged "bad bank" to be established by the National Bank of Hungary is reported to begin buying distressed corporate debt from banks at market prices.

Romania

Romania achieved a 3.5 per cent increase in real GDP in 2013, with the impetus for growth coming mainly from the agricultural sector and exports. The rate of inflation increased to 4.0 per cent, but unemployment was virtually unchanged at 5.7 per cent, by far the lowest level among the nine countries in the study. The budget deficit was unchanged at 2.5 per cent of GDP, and although public debt increased by 3.5 points to 36.8 per cent, this was still the second lowest behind Bulgaria.

The volume of retail loans contracted at a moderate pace, but corporate loan volume shed a considerable 6.1 per cent.

Among the nine countries, the speed of deterioration in loan portfolio quality has been fastest in Romania, along with Serbia. The volume of retail and corporate NPLs surged in 2013, by 15.6 per cent and 13.9 per cent respectively. The retail NPL ratio increased by two percentage points, but the corporate NPL ratio jumped by 5.1 points to a worrying 29.1 per cent. This corporate NPL ratio is the highest among the nine countries and retail NPL ratio is the second-highest, behind Hungary.

The capital adequacy ratio remained much the same as in 2012, at 15.0 per cent. This is reasonably good, although below the 16.7 per cent average for the nine countries. Both ROE and ROA improved substantially and turned from negative to positive, and the cost/income ratio fell by 3.3 points to 55.7 per cent. The loans/deposits ratio trended downwards by 4.4 percentage points to 82.5 per cent, which is the second lowest behind the Czech Republic and mirrors a self-financing banking sector. The FX share of lending fell by 2.0 points arriving to 61.0 per cent, which is one of the highest proportions among the nine countries.

Table 17. Key metrics in Romania

Macro	2012	2013	Change (% point)
GDP (% real change pa)	0.7%	3.5%	2.8%
Consumer prices (% change pa)	3.3%	4.0%	0.7%
Recorded unemployment (%)	5.6%	5.7%	0.1%
Budget balance (% of GDP)	-2.5%	-2.5%	0.0%
Public debt (% of GDP)	33.3%	36.8%	3.5%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (RON mn)	104,724	103,540	-1.1%
Corporate loans (RON mn)	120,856	113,483	-6.1%
NPL volumes			
Retail NPLs (RON mn)	12,237	14,150	15.6%
Corporate NPLs (RON mn)	29,011	33,033	13.9%
NPL ratios			
Retail NPL ratio (%)	11.7%	13.7%	2.0%
Corporate NPL ratio (%)	24.0%	29.1%	5.1%
Key ratios			
CAR (%)	14.9%	15.0%	0.1%
ROE (%)	-6.4%	0.8%	7.2%
ROA (%)	-0.7%	0.1%	0.7%
CIR (%)	58.9%	55.7%	-3.3%
L/D (%)	86.9%	82.5%	-4.4%
FX share of lending (%)	63.0%	61.0%	-2.0%

Source: EIU, NBH, ECB CBD

Among the nine countries, the speed of deterioration in loan portfolio quality has been fastest in Romania, along with Serbia.

The Romanian banking sector suffers from the highest NPL ratio among the nine countries, while profitability is also merely zero positive. None of the top ten banks has a NPL ratio below 10 per cent, while for Alpha Bank and Bancpost the ratio is about 15 per cent, for CEC Bank around 20 per cent, for BDR about 25 per cent, and for the market leader BCR it is a woeful 30 per cent. Of these banks, only BDR reported a net loss in 2013; BCR, Unicredit Tiriac and CEC Bank made some profit, while Banca Transilvania and Raiffeisen achieved a reasonable ROE. Asset concentration in the banking sector is about average for the nine countries. The top three, five and ten banks hold 39 per cent, 53 per cent and 77 per cent of total assets, compared with regional averages of 42 per cent, 56 per cent and 77 per cent. Equity concentration, at 42 per cent, 55 per cent and 75 per cent for the top three, five and ten Romanian banks, is lower than the regional averages of 47 per cent, 60 per cent and 80 per cent. The largest bank is is BCR (owned by Erste) with a market share of 17.2 per cent,, the second is BRD (owned by Société Générale) with 12.8 per cent, and the third is Banca Transilvania in dispersed private ownership with 8.7 per cent. Banks with domestic ownership are the state-owned CEC Bank and Banca Transilvania, where domestic ownership is 43.8 per cent and spread among 27,000 shareholders: the remaining 56.2 per cent of the bank's equity is held by about 750 foreign owners, including EBRD (owning 14.6 per cent) and IFC (3.5 per cent). Greek Alpha Bank and Eurobank own the eighth- and tenth-largest Romanian banks.

The Romanian debt sales market stepped up a gear in 2014, with several large flagship transactions completed.

Consumer portfolios of PLN 2.5bn were offered for sale in 2012 for an average price of six per cent which is relatively low by international comparison. Transaction volumes were about the same in 2013, but average prices increased substantially to 10 per cent.

Among NPL investors, Kruk excels as a market leader with a market share of about 55 per cent, followed by Kredyt Inkaso (about eight per cent) and the rest of the market consists of other investors, including EOS, Coface and Mellon.

Table 18. Top players in the Romanian banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	BCR	14,012	1,689	76	0.5%	4.5%	30.6%	Erste
2	BRD	10,398	1,165	-85	-0.8%	-7.3%	24.8%	Société Générale
3	Banca Transilvania	7,077	694	83	1.2%	12.0%	12.6%	Private
4	Unicredit Tiriac	6,061	636	17	0.3%	2.7%	11.1%	UniCredit
5	CEC Bank	5,936	465	10	0.2%	2.2%	19.5%*	State
6	Raiffeisen	5,844	692	106	1.8%	15.3%	11.6%	Raiffeisen
7	ING	4,020	FB	n/a	n/a	n/a	n/a	ING
8	Alpha Bank	3,588	409	n/a	n/a	n/a	14.4%	Alpha Bank
9	Volksbank	3,049	270	n/a	n/a	n/a	n/a	Volksbank
10	Bancpost	2,620	257	n/a	n/a	n/a	15.3%*	Eurobank Ergasias
	Banking sector total	**81,502**	**8,420**	**64**	**0.1%**	**0.8%**	**21.9%**	

*2012 data
Source: Banks' data disclosure, NBR, ECB CBD, ISI Emerging Markets
FB: foreign branch

Table 19. Romanian consumer debt market

PLN bn	Portfolios offered for sale	Average prices
2013	2.6	10%
2012	2.5	6%

Source: Kruk

The Romanian debt sales market stepped up a gear in 2014, with several large flagship transactions completed.

Markets in non-performing mortgage loans and corporate debt were virtually non-existent until 2014 when there were a number of pioneering large-scale transactions, prompted by the approaching results of the AQR. The strongest recent debt sales market spring-up is experienced in Romania, buoyed by the below landmark transactions.

In 2013 Citibank and RBS sold their entire consumer and retail businesses to Raiffeisen and UniCredit, containing both PLs and NPLs. In July 2014 Volksbank sold NPLs with a face value of €495mn to a consortium of DB, AnaCap, H.I.G Capital and APS: 84 per cent of the portfolio were retail mortgages and 16 per cent were corporate NPLs.

Also in July 2014, BCR sold a portfolio of corporate NPLs, with a face value of €250mn, to DB and APS. BCR is also reported be planning the sale of another €550 mn NPL portfolio before the end of 2014. In August, RBS sold its corporate business to UniCredit, containing both PLs and NPLs. Also in August, MKB sold Corporate Recovery Management S.A. with its distressed corporate portfolio to APS.

Overall, the Romanian debt sales market is booming, with strong interest on both the banks' and investors' sides. This foreshadows that many further transactions should therefore be expected in the future.

Table 20. Major NPL transactions in Romania, 2014

Date	Country	Seller	Buyer	Type of portfolio	PL or NPL?	Portfolio size (EUR mn)	Approx. price (EUR mn)	Deloitte involvement	Consummated?
Sep-14	Romania	Bank of Cyprus	Confidential	Corporate	NPL	Confidential	95	Sell side legal advisor	Yes
Aug-14	Romania	MKB	APS	Corporate Recovery Management S.A. (Corporate)	NPL	85*	Confidential	Sell side financial advisor	Yes
Aug-14	Romania	RBS	UniCredit	Corporate business	PL, NPL	260 (assets)	Confidential		Yes
Jul-14	Romania	Volksbank	DB, AnaCap, H.I.G Capital, APS	Mortgage (84%) and corporate (16%) loans	NPL	495	Confidential		Yes
Jul-14	Romania	BCR	DB, APS	Corporate	NPL	250	Confidential		Yes
Apr-13	Romania	RBS	UniCredit	Retail business	PL, NPL	315 (assets)	Confidential		Yes
Mar-13	Romania	Citibank	Raiffeisen Bank	Consumer business	PL, NPL	90	Confidential		Yes

* Gross client receivables as of 31 Dec 2013

Croatia

Croatia has not yet recovered from the recession and suffered a dip of one per cent in real GDP in 2013, brought about by both struggling domestic demand and weak net exports. This is the worst economic performance among the nine countries in the survey. However the rate of decline in GDP slowed down compared to 2012, by 0.9 percentage points. Deriving from subdued domestic demand inflation subsided by 1.2 per cent point to 2.2 per cent. In alignment with anaemic economic performance, unemployment climbed further exceeding 20 per cent, which is excruciating, and the second highest value behind the extreme 27.2 per cent data of Serbia. The budget deficit ballooned by 2.8 points to 6.1 per cent, contributing to a surge of 7.1 points in the public debt to 61.1 per cent which, along with Serbia, is the second-highest level behind Hungary among the nine countries.

The volume of retail loans contracted by 1.7 per cent, while corporate loans levelled out.

The position with regard to NPLs is fairly bleak, which is not surprising in view of the protracted recession. The volumes of retail and corporate NPLs increased by 15.2 per cent and 12.6 per cent respectively, and retail and corporate NPL ratios rose by 1.6 per cent and 3.2 per cent. The corporate NPL ratio is the highest amid the nine countries and mirrors a substantially contaminated corporate portfolio.

The capital adequacy ratio flattened out at 20.9 per cent. This is the highest among the nine countries, and suggests that the banking sector has a strong shock-absorbing capability. Considerable portfolio quality deterioration weighed heavily on profitability ratios, ROE and ROA were compressed by 3.6 and 0.5 percentage points, respectively. Chiming together with this profitability deterioration, CIR also crept upwards by 0.4 percentage point. Albeit the loans/deposits ratio abated slightly, it is still well above 100 per cent. The FX share of lending was unchanged at 74 per cent, but this is the highest among the nine countries. Even so, it is not considered a major problem since the volatility of the kuna is fairly limited.

Table 21. Key metrics in Croatia

Macro	2012	2013	Change (% point)
GDP (% real change pa)	-1.9%	-1.0%	0.9%
Consumer prices (% change pa)	3.4%	2.2%	-1.2%
Recorded unemployment (%)	19.1%	20.3%	1.2%
Budget balance (% of GDP)	-3.3%	-6.1%	-2.8%
Public debt (% of GDP)	54.0%	61.1%	7.1%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (HRK mn)	129,636	127,426	-1.7%
Corporate loans (HRK mn)	108,312	108,224	-0.1%
NPL volumes			
Retail NPLs (HRK mn)	12,304	14,173	15.2%
Corporate NPLs (HRK mn)	27,031	30,431	12.6%
NPL ratios			
Retail NPL ratio (%)	9.5%	11.1%	1.6%
Corporate NPL ratio (%)	25.0%	28.1%	3.2%
Key ratios			
CAR (%)	20.9%	20.9%	0.0%
ROE (%)	4.9%	1.3%	-3.6%
ROA (%)	0.7%	0.2%	-0.5%
CIR (%)	51.7%	52.2%	0.4%
L/D (%)	119.2%	116.2%	-3.0%
FX share of lending (%)	74.0%	74.0%	0.0%

Source: EIU, NBH, ECB CBD

The corporate NPL ratio is the highest amid the nine countries and mirrors a substantially contaminated corporate portfolio.

The Croatian banking sector underperforms expectations of owners, with high NPL ratios and anaemic profitability. Among the top ten banks, Hrvatska Postanska Banka has the highest NPL ratio with 23.5 per cent, Erste is also above a worrisome 20 per cent, whereas market leading Zagrebacka Banka also posts an unhealthy 18.3 per cent. Only Privredna Banka Zagreb and the small Kreditna Banka keep their NPL ratio under 10 per cent. Although only two banks, HAA and Sberbank, reported losses in 2013, profitability of profit making banks is also meagre. The highest ROE, 7.3 per cent, was achieved by Privredna Banka Zagreb and Raiffeisenbank Austria. Asset concentration is the second highest amongst the nine countries, behind Hungary. The top three, five and ten banks hold 56 per cent, 71 per cent and 89 per cent of total banking assets. Equity concentration is also greater than the average among the nine countries, with the top three, five and ten banks accounting for 53 per cent, 72 per cent and 86 per cent of the banking sector's total equity. Zagrebacka Banka, owned by UniCredit, is the largest bank with a market share of 25.7 per cent, followed by Privredna Banka Zagreb (owned by Intesa) and Erste with 15.8 per cent and 14.5 per cent market shares respectively. Eight of the ten largest banks are foreign-owned. Hrvatska Postanska Banka, the only state-owned bank, is in the process of being privatised. Bids from Erste and OTP were both rejected by the government, but a second attempt at privatisation is expected soon. The only top ten bank with private Croatian ownership is the smaller-scale Kreditna Banka.

Table 22. Top players in the Croatian banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	Zagrebacka Banka	14,056	1,962	77	0.5%	3.9%	18.3%	UniCredit
2	Privredna Banka Zagreb	8,658	1,412	103	1.2%	7.3%	7.4%	Intesa Sanpaolo
3	Erste	7,907	710	12	0.2%	1.7%	21.1%	Erste
4	Raiffeisenbank Austria	4,342	602	44	1.0%	7.3%	13.9%	Raiffeisen
5	Hypo Alpe-Adria-Bank	3,955	858	-91	-2.3%	-10.6%	12.4%	HAA
6	Splitska Banka	3,596	418	1	0.0%	0.2%	12.1%	Société Générale
7	Hrvatska Postanska Banka	2,416	207	6	0.2%	2.9%	23.5%	State
8	Otp Banka Hrvatska	1,794	210	7	0.4%	3.5%	12.5%	OTP
9	Sberbank	1,219	175	-7	-0.6%	-4.0%	n/a	Sberbank
10	Kreditna Banka	539	40	1	0.1%	1.6%	5.0%	Croatian citizens
	Banking sector total	**54,699**	**7,690**	**101**	**0.2%**	**1.3%**	**15.6%**	

Source: Banks' data disclosure, CNB, ECB CBD, ISI Emerging Markets

The Croatian banking sector underperforms expectations of owners, with high NPL ratios and anaemic profitability.

Slovenia

Slovenia's real GDP fell by 0.9 per cent in 2013, and although this was not as bad as the 2.4 per cent fall in 2012, the country is still mired in recession. Due to declining investments and domestic demand, inflation was muted. In accordance with anaemic economic performance, unemployment climbed by 1.1 percentage point. The budget deficit increased by 1.2 point to 4.4 per cent and public debt ballooned 9.1 points: this huge increase was caused largely by the cost of due diligence of the banking sector by international advisors and a rescue package for troubled banks to stave off bankruptcy, which cost about €3bn in 2013. Moreover, Slovenia narrowly avoided having to seek an international financial bailout.

Outstanding retail loans shrank by 3.8 per cent, but retail NPLs increased by 4.1 per cent, as a result of a higher NPL ratio, which however is still the third-lowest value among the nine countries in the study, behind Slovakia and the Czech Republic. The reason for meaningfully lower retail NPL ratios relative to corporate NPL ratios is that Slovenia has a much higher rate of home ownership than other peer countries in the region which is a result of the government`s home ownership policy in the early 1990. Consequently, there was less demand for home loans and thus we see fewer retail NPLs today.

The most acute NPL problem in Slovenia relates to corporate lending. In 2012, the volume of outstanding corporate loans fell by 7.2 per cent, whereas corporate NPL volumes increased sharply by 14.4 per cent, together with a jump of 4.3 percentage points in the corporate NPL ratio. As almost half the banking sector is in state ownership – following the recommendation of the European Council – the government decided on a thorough scrutiny of the banking sector, and a comprehensive asset quality review (AQR) was carried out in 2013. This revealed a huge provisioning gap for NPLs and a capital shortfall of about €5 billion. A large amount of bad corporate assets were identified, and the government decided to set up a 'bad bank', the Bank Asset Management Company (BAMC) to take over the banks' troubled corporate exposures. NPL transfers from the two largest banks, NLB and NKBM (both state-owned) began towards the end of 2013 and are still continuing. The total amount of planned transfers from these two banks, in five packages, is about €3.3bn, in a roughly two thirds/one third distribution for NLB and NKBM.

Table 23. Key metrics in Slovenia

Macro	2012	2013	Change (% point)
GDP (% real change pa)	-2.4%	-0.9%	1.5% ●
Consumer prices (% change pa)	2.6%	1.8%	-0.8% ●
Recorded unemployment (%)	12.0%	13.1%	1.1% ●
Budget balance (% of GDP)	-3.2%	-4.4%	-1.2% ●
Public debt (% of GDP)	47.6%	56.7%	9.1% ●
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (EUR mn)	9,267	8,918	-3.8% ●
Corporate loans (EUR mn)	18,643	14,191	-23.9% ▬
NPL volumes			
Retail NPLs (EUR mn)	454	473	4.1% ●
Corporate NPLs (EUR mn)	4,251	2,895	-31.9% ▬
NPL ratios			
Retail NPL ratio (%)	4.9%	5.3%	0.4% ●
Corporate NPL ratio (%)	22.8%	20.4%	-2.4% ▬
Key ratios			
CAR (%)	11.5%	11.8%	0.3% ●
ROE (%)	-19.5%	-96.8%	-77.3% ●
ROA (%)	-1.6%	-8.3%	-6.7% ●
CIR (%)	47.4%	66.1%	18.6% ●
L/D (%)	102.7%	96.4%	-6.3% ●
FX share of lending (%)	0.0%	0.0%	0.0% ●

▬ Significant write-downs had to take place in 2013; and tranfser of corporate NPLs from NLB and NKBM to the national Bad Bank (BAMC) already started at the end of 2013.

Source: EIU, NBH, ECB CBD

A large amount of bad corporate assets were identified, and the government decided to set up a 'bad bank', the Bank Asset Management Company (BAMC) to take over the banks' troubled corporate exposures.

The transfer of NPLs from Abanka, the third largest bank which was nationalised at the end of 2013, commenced in 2014, with plans to transfer loans of about €0.5bn to BAMC. BAMC has also recently reached an agreement with the smaller Probanka and Factor Banka to take over €28m and €11mn respectively of their soured corporate exposures.

Despite heavy losses among the banks, their capital adequacy ratio increased slightly in 2013, due to capital injections provided by the state; however the CAR in Slovenia is still by far the lowest among the nine countries in the study. Profitability indicators –which were already deeply the worst amid the nine – were wreaked havoc by immense losses and thus plummeted further from already disappointing levels. ROE collapsed by 77.3 per cent points to an unprecedented -96.8 per cent, ROA plunged from -1.6 per cent to -8.3 per cent, while CIR also exploded from 47.4 per cent to 66.1 per cent due to tumbling revenues and higher operating costs related to the AQR. The loans/deposit ratio receded somewhat and dwindled under 100 per cent.

The stricken Slovene banking sector is by far the most problematic of the nine countries, devastated by high NPL ratios and huge additional provisions necessitated by the pilot AQR of ECB and entailing disastrous profitability. The pilot project of the AQR was carried out in Slovenia, where four of the ten largest banks, including the top three, are state-owned. Political connections and motives had played a special role in lending activities, resulting in large amounts of NPLs for the banks. Three of the four top state-owned banks lost more than their total equity in 2013 so that their ROEs were negative by more than 100 per cent. (The fourth state-owned bank, SID Banka, made a limited profit.) Besides SID Banka, only Banka Koper and Sberbank were profitable, although only marginally so. The ROE of the fourth-largest bank, Abanka Vipa, was also negative by more than 100 per cent and its ROA was about minus 10 per cent. The NPL ratio of this bank, at 44.2 per cent, is the highest among the ninety banks in this study.

Table 24. Top players in the Slovene banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	NLB	9,553	1,097	-1,540	-16.1%	-140.3%	20.4%	State
2	NKBM	3,928	519	-657	-16.7%	-126.7%	18.0%	State
3	SID Banka	3,805	348	5	0.1%	1.4%	7.1%	State
4	Abanka Vipa	3,051	214	-309	-10.1%	-144.3%	44.2%	Zavarovalnica Triglav
5	UniCredit Banka	2,501	229	-39	-1.6%	-17.0%	17.0%	UniCredit
6	SKB Banka	2,463	269	-32	-1.3%	-11.9%	6.8%	Société Générale
7	Banka Koper	2,312	268	3	0.1%	1.1%	8.6%	Intesa Sanpaolo
8	Banka Celje	1,824	41	-127	-7.0%	-308.2%	31.2%	NLB
9	Gorenjska Banka	1,569	167	-116	-7.4%	-69.5%	25.0%	Sava
10	Sberbank Banka	1,485	119	1	0.1%	0.8%	11.5%	Sberbank
	Banking sector total	**44,466**	**3,810**	**-3,688**	**-8.3%**	**-96.8%**	**13.8%**	

Source: Banks' data disclosure, CNB, ECB CBD, ISI Emerging Markets

The NPL ratio is also above 30 per cent for Banka Celje and above 20 per cent for Gorenjska Banka and the market leader NLB. On the other hand, SID Banka, SKB Banka and Banka Koper managed to keep their NPL ratio below 10 per cent. Asset concentration among Slovenian banks is close to the average for the nine countries: the top three, five and ten banks hold 39 per cent, 51 per cent and 73 per cent of total banking assets. Equity concentration is also close to the regional average, with the top three, five and ten banks accounting for 52 per cent, 63 per cent and 86 per cent of total equity in the banking sector. As already mentioned, the three largest banks are all state-owned: NLB has a market share of 21.5 per cent, followed at a distance by NKBM and SID Banka with 8.8 per cent and 8.6 per cent respectively. Domestic ownership of Slovenian banks is extensive, with four state-owned banks among the top ten. In addition, Abanka Vipa is owned by Zavarovalnica Triglav, Banka Celje is owned by NLB and Gorenjska Banka is possessed by Sava.

Serbia

Serbia achieved an increase in real GDP of 2.5 per cent in 2013, after a fall of 1.5 per cent in 2012 propelled by both higher domestic demand and exports. Inflation rose slightly to 7.6 per cent on the back of perked-up demand. Unemployment is a severe problem: at 27.2 per cent the level of unemployment rate is the highest among all nine countries in the study and it continues to rise. Albeit Although the budget deficit was reduced by 1.6 points to 4.9 per cent, public debt crept 1.9 points to 61.2 per cent of GDP.

The volume of outstanding retail loans increased slightly but corporate loans fell by 8.7 per cent, a substantial amount.

Retail NPLs picked up by 16.4 per cent, but from a low base; however corporate NPLs surged by 17.5 per cent from a level that was already high. The NPL ratio for retail loans increased by 1.3 points to 11.2 per cent, and the corporate NPL ratio jumped by 6.1 points to 27.3 per cent which is the second-highest level among the nine countries, behind Croatia.

The capital adequacy ratio remained unchanged at 19.9 per cent, indicating a robust capital adequacy. The profitability of banks fell, however: ROE and ROA declined by 2.4 and 0.4 points respectively, and both turned negative in 2013, having been positive in 2012. Although the cost/income ratio improved by 1.8 points to 65.5 per cent, it is still the second highest behind Slovenia, and well in excess of the 57.3 per cent average for all the nine countries.

There was a large fall of nine points in the loans/deposits ratio, but it remains well above 100 per cent. The FX share of lending was unchanged but at 72 per cent it is higher than any other of the nine countries except for Croatia.

Table 25. Key metrics in Serbia

Macro	2012	2013	Change (% point)
GDP (% real change pa)	-1.5%	2.5%	4.0%
Consumer prices (% change pa)	7.4%	7.6%	0.2%
Recorded unemployment (%)	25.9%	27.2%	1.3%
Budget balance (% of GDP)	-6.5%	-4.9%	1.6%
Public debt (% of GDP)	59.3%	61.2%	1.9%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (EUR mn)	5,828	6,015	3.2%
Corporate loans (EUR mn)	11,286	10,306	-8.7%
NPL volumes			
Retail NPLs (EUR mn)	580	675	16.4%
Corporate NPLs (EUR mn)	2,393	2,812	17.5%
NPL ratios			
Retail NPL ratio (%)	9.9%	11.2%	1.3%
Corporate NPL ratio (%)	21.2%	27.3%	6.1%
Key ratios			
CAR (%)	19.9%	19.9%	0.0%
ROE (%)	2.0%	-0.4%	-2.4%
ROA (%)	0.4%	-0.1%	-0.4%
CIR (%)	67.3%	65.5%	-1.8%
L/D (%)	125.0%	116.0%	-9.0%
FX share of lending (%)	72.0%	72.0%	0.0%

Source: EIU, NBH, ECB CBD

Unemployment is a severe problem: at 27.2 per cent the level of unemployment rate is the highest among all nine countries in the study.

The Serbian banking sector as a whole was loss-making in 2013 and had the second highest NPL ratio in the region, behind Romania. The largest banks seem to have less contaminated loan portfolios than the banking sector as a whole, as they all have NPL ratios below the 21.4 per cent average. Even so, the NPL ratio for each of the top ten banks is above 12 per cent, with the exception of Société Générale Banka, indicating serious portfolio quality issues. EFG Eurobank has the highest NPL ratio but this is below 20 per cent. Only two of the top banks, Société Générale Banka and HAA, incurred losses in 2013: the ROE was minus 3.8 per cent for the former and a painful minus 16.0 per cent for the latter. Sectorial ROA of -0.1 per cent generally implies a lower ROE than -0.4 per cent, which is likely attributable to the outstandingly high 19.9 per cent CAR of the Serbian banking sector. Asset concentration is the second lowest among the nine countries, behind Poland. The top three, five and ten banks hold 33 per cent, 47 per cent and 67 per cent of total banking assets. Equity concentration is the lowest in the region for the top three and top five banks (which account for 36 per cent and 51 per cent of banking equity; however it is only the fifth lowest for the top ten banks, at 77 per cent. The largest bank is Banca Intesa with a market share of 13.6 per cent, followed by Komercijalna Banka with 11.6 per cent and UniCredit Banka with 8.0 per cent. Three of the ten largest banks are in domestic ownership: the state-owned Komercijalna Banka, privately-owned AIK Banka and Banka Poštanska, owned by the Serbian Post.

Table 26. Top players in the Serbian banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	Banca Intesa	3,743	865	82	2.2%	9.5%	12.4%	Intesa Sanpaolo
2	Komercijalna Banka	3,186	568	41	1.3%	7.2%	17.5%	State
3	UniCredit Banka	2,209	443	32	1.4%	7.2%	13.8%	UniCredit
4	Société Générale Banka	1,937	292	-11	-0.6%	-3.8%	9.4%	Société Générale
5	Raiffeisen Banka	1,801	494	55	3.1%	11.1%	13.1%	Raiffeisen
6	EFG Eurobank	1,386	410	12	0.9%	2.9%	19.4%	Eurobank Ergasias
7	AIK Banka	1,336	451	11	0.8%	2.4%	n/a	ABG
8	HAA	1,099	249	-40	-3.6%	-16.0%	16.6%*	HAA
9	Vojvođanska Banka	955	172	12	1.3%	7.0%	n/a	NBG
10	Banka Poštanska	872	110	1	0.1%	0.9%	n/a	JP PTT Saobraćaja
	Banking sector total	**27,485**	**5,260**	**-21**	**-0.1%**	**-0.4%**	**21.4%**	

*2012 data
Source: Banks' data disclosure, NBS, ECB CBD, ISI Emerging Markets
FB: foreign branch

Bulgaria

Real GDP growth in Bulgaria has been sluggish: growth in 2013 was 0.9 per cent, a meagre 0.3 point improvement on 2012. The positive effects of higher net exports and public expenditure were retracted by downturns in private consumption and investment. The annual rate of inflation fell by 2.1 points to 0.9 per cent, which might arise deflation woes. Unemployment climbed slightly to 11.3 per cent. The budget deficit increased by 1.3 points, but at 1.8 per cent it was still well below the Maastricht limit. Public debt as a percentage of GDP is by far the lowest among the nine countries in the study.

The volume of both retail and corporate loans outstanding remained at about the same level as in 2012 in nominal value, and contracted in real terms.

Both retail and corporate NPL volumes increased, although only by 2.7 per cent; and the retail and corporate NPL ratios rose by 0.3 points and 0.4 points respectively. The corporate NPL ratio at 19.3 per cent is also among the higher levels for the nine countries, and the retail NPL ratio at 13.3 per cent is the second highest behind Hungary (where the huge amounts of pre-crisis FX lending had a devastating effect on the retail NPL ratio).

The capital adequacy ratio increased slightly, and at 16.9 per cent is robust. Both ROE and ROA for the banking sector remained unchanged at 5.3 per cent and 0.7 per cent respectively. There was some deterioration in the cost/income ratio, and the loans/deposit ratio fell by 6.2 points to below 90 per cent. The FX share of lending subsided by three points to 61 per cent, but since the Bulgarian lev is pegged to the euro, this is not seen as a problem.

Bulgaria has recently experienced serious issues in its banking sector. In June 2014 there was a run on two banks by depositors, due to malicious rumours and text messages that were intended to destabilise the banking system. Corporate Commercial Bank, the fourth largest bank, was the first to be attacked and about €500 million deposits were withdrawn in two days. Several days later First Investment Bank, the third largest lender, also suffered an organised attack, during which about €400 million deposits were withdrawn. Later, as a result of suspicious transactions, the licence of Corpbank was revoked and the bank was put under state administration. First Investment Bank resisted the attack and its share price recovered quickly after having plummeted temporarily due to market panic.

Table 27. Key metrics in Bulgaria

Macro	2012	2013	Change (% point)
GDP (% real change pa)	0.6%	0.9%	0.3%
Consumer prices (% change pa)	3.0%	0.9%	-2.1%
Recorded unemployment (%)	11.1%	11.3%	0.2%
Budget balance (% of GDP)	-0.5%	-1.8%	-1.3%
Public debt (% of GDP)	18.4%	18.6%	0.2%
Banking sector	**2012**	**2013**	**Change (% or % point)**
Retail loans (EUR mn)	9,208	9,252	0.5%
Corporate loans (EUR mn)	19,083	19,153	0.4%
NPL volumes			
Retail NPLs (EUR mn)	1,198	1,230	2.7%
Corporate NPLs (EUR mn)	3,598	3,695	2.7%
NPL ratios			
Retail NPL ratio (%)	13.0%	13.3%	0.3%
Corporate NPL ratio (%)	18.9%	19.3%	0.4%
Key ratios			
CAR (%)	16.7%	16.9%	0.2%
ROE (%)	5.3%	5.3%	0.0%
ROA (%)	0.7%	0.7%	0.0%
CIR (%)	52.0%	53.5%	1.6%
L/D (%)	94.8%	88.6%	-6.2%
FX share of lending (%)	64.0%	61.0%	-3.0%

Source: EIU, NBH, ECB CBD

Bulgaria has recently experienced serious issues in its banking sector. In June 2014 there was a run on two banks by depositors.

NPL ratios in the Bulgarian banking sector are high, while profitability is positive but not sufficient. Although the average NPL ratio for the banking sector (14.5 per cent) is at the median level for the nine countries, some individual large banks post very high NPL ratios. United Bulgarian Bank has an alarming ratio of 32.9 per cent, for Alpha Bank it is around 25 per cent, and for both OTP and Raiffeisen it is above 20 per cent. Central Cooperative Bank however has an outstandingly low NPL ratio of 2.4 per cent. Although only Raiffeisen among the top ten banks made a loss in 2013, the return on equity for most of the banks was unsatisfactory. ROE for UniCredit Bulbank was approaching ten per cent, and was above ten per cent for DSK Bank. (As mentioned previously, Corporate Commercial Bank was put under state administration due to suspicious transactions thus its reported profit and ROE in 2013 may therefore be unreliable.) Asset concentration among the largest three and five banks is lower than the average for the nine countries and around the average for the top ten banks. The top three, five and ten banks hold 35 per cent, 51 per cent and 78 per cent of total banking assets respectively: the corresponding figures for the nine countries together are 42 per cent, 56 per cent and 77 per cent. Equity concentration is also less than average: the top three, five and ten banks in Bulgaria account for 38 per cent, 54 per cent and 77 per cent of the total equity, compared with regional averages of 47 per cent, 60 per cent and 80 per cent. The largest bank is UniCredit Bulbank with a market share of 15.2 per cent, followed by DSK bank (owned by OTP) and the privately-owned First Investment Bank with market shares of 10.6 per cent and 8.9 per cent, respectively. Three of the largest ten banks are in domestic ownership: First Investment Bank (FIB), Corporate Commercial Banka and Central Cooperative Bank. FIB is owned by Tzeko Minev (28.94 per cent) and Ivailo Mutafchiev (also 28.94 per cent); Corporate Commercial Banka was controlled by Tzvetan Vassilev (through Bromak EOOD) before being put under state administration; and Central Cooperative Bank is owned by state-owned CCB Group.

Table 28. Top players in the Bulgarian banking sector

#	Bank (2013, EUR mn)	Assets	Equity	Net Profit	ROA	ROE	NPL ratio	Major owner
1	UniCredit Bulbank	6,539	1,111	104	1.6%	9.4%	17.0%	UniCredit
2	DSK Bank	4,562	765	98	2.1%	12.8%	20.1%	OTP
3	First Investment Bank	3,826	276	13	0.3%	4.7%	16.9%	Private
4	Corporate Commercial Bank	3,463	312	36	1.0%	11.6%	17.2%	Bromak
5	United Bulgarian Bank	3,450	559	9	0.3%	1.6%	32.9%	NBG
6	Raiffeisen	3,062	443	-22	-0.7%	-5.0%	20.1%	Raiffeisen
7	Eurobank Bulgaria	2,928	424	13	0.4%	3.1%	17.5%	EFG Eurobank
8	Central Cooperative Bank	1,925	184	6	0.3%	3.3%	2.4%	CCB Group
9	Soc. Gén. Expressbank	1,883	255	12	0.6%	4.7%	12.7%	Société Générale
10	Alpha Bank	1,878	FB	0	0.0%	n/a	25.5%	Alpha Bank
	Banking sector total	**42,930**	**5,620**	**299**	**0.7%**	**5.3%**	**14.5%**	

Source: Banks' data disclosure, NBS, ECB CBD, ISI Emerging Markets

NPL ratios in the Bulgarian banking sector are high, while profitability is positive but not sufficient.

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