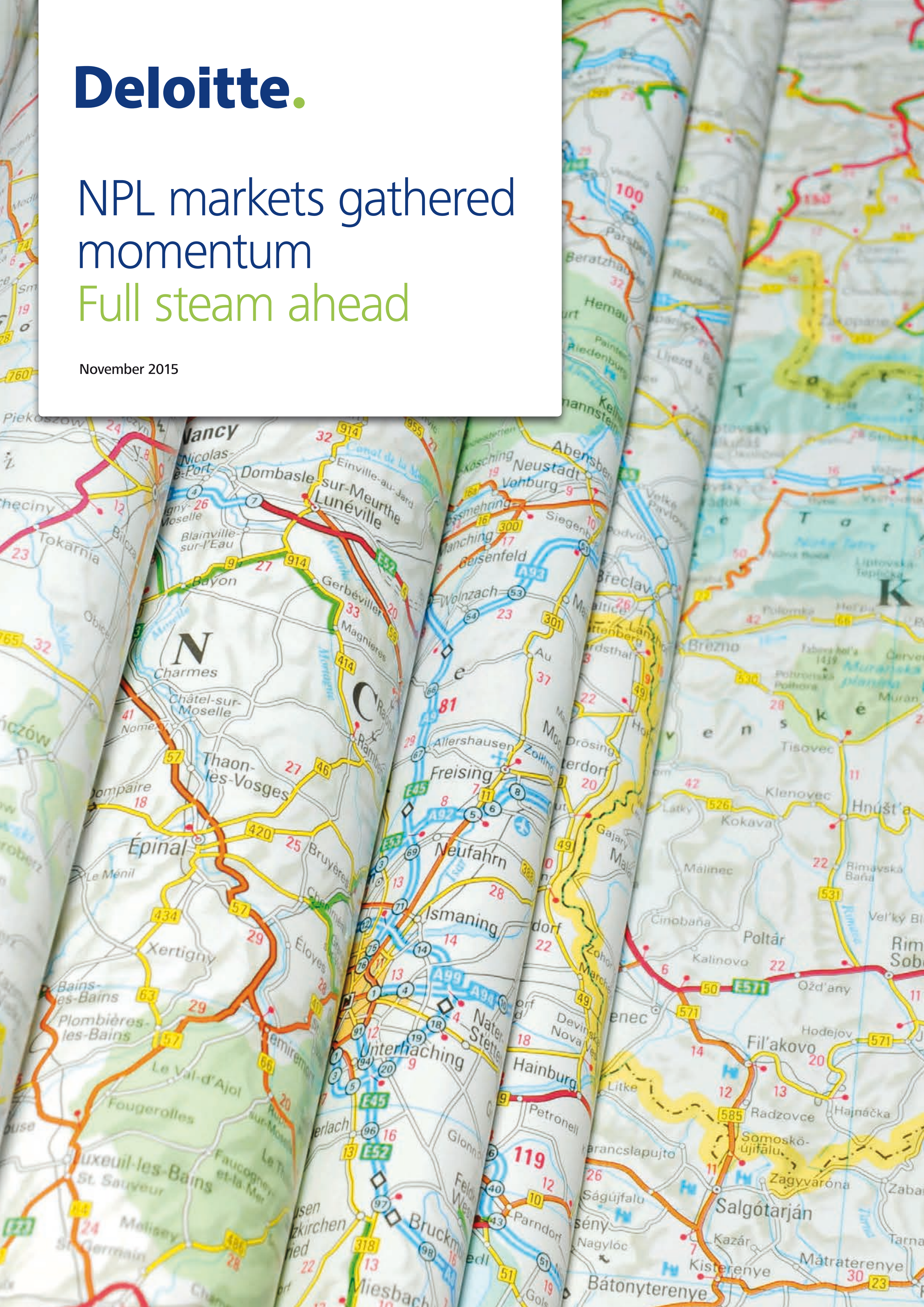
NPL markets gathered momentum

Full steam ahead

November 2015



Contents

Abbreviations

AQR – Asset Quality Review

BAMC – Bank Asset Management Company

BEVA – Investor Protection Fund

BG – Bulgaria

bn – Billion

BNB – Bulgarian National Bank

BSI – Bank of Slovenia

CAR – Capital Adequacy Ratio

CE – Central Europe

CEE – Central and Eastern Europe

CESEE – Central, Eastern and Southeastern Europe

CHF – Swiss Franc

CIR – Cost-to-income ratio

CNB – Czech National Bank

CR – Croatia

CRD – Capital Requirements Directive

CRE – Commercial real estate

CRR – Capital Requirements Regulation

CZ – Czech Republic

CZK – Czech Koruna

DPD – Days past due

EBRD – European Bank for Reconstruction and Development

ECB – European Central Bank

ECB CBD – European Central Bank Consolidated banking data

EIB – European Investment Bank

EIU – Economist Intelligence Unit

EU – European Union

EUR – Euro

FGS – Funding for Growth Scheme

FX – Foreign exchange

GDP – Gross Domestic Product

HNAM – Hungarian National Asset Management Inc.

HNB – Croatian National Bank

HRK – Croatian kuna

HU – Hungary

HUF – Hungarian forint

LIBOR – London Interbank Offered Rate

L/D ratio (L/D) – Loan-to-deposit ratio

MARK – Hungarian Restructuring and Debt Management Company

mn – Million

MoU – Memorandum of Understanding

M&A – Mergers and Acquisitions

NBR – National Bank of Romania

NBH – National Bank of Hungary

NBP – National Bank of Poland

NBS – National Bank of Slovakia/National Bank of Serbia

NPE – Non-performing exposure

NPL – Non-performing loan

OBA – Deposit Insurance Fund

PL – Performing loan

PL – Poland

PLN – Polish zloty

RO – Romania

ROA – Return on Assets

ROE – Return on Equity

RON – Romanian leu

SI – Slovenia

SK – Slovakia

SME – Small and medium-sized enterprises

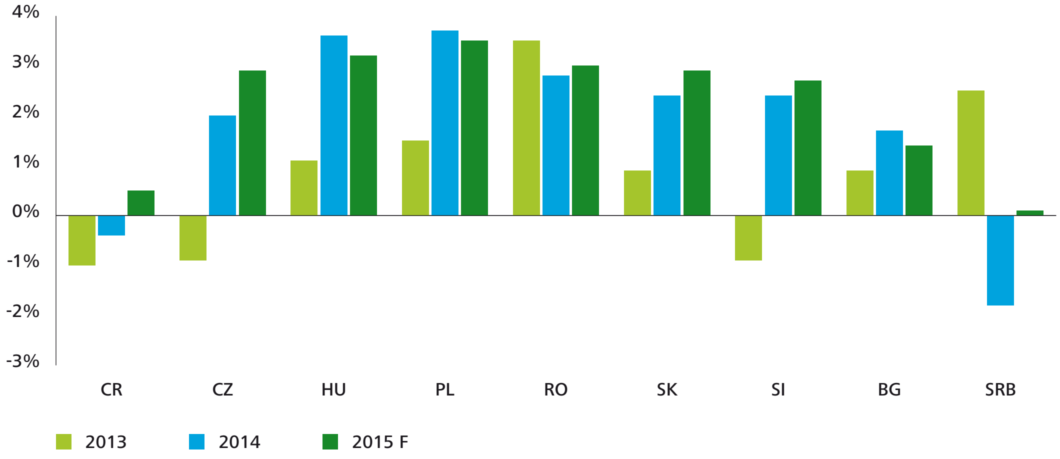
SNB – Swiss National Bank

SRB – Serbia

VAT – Value-added tax

Macro overview

Figure 1. Changes in real GDP, 2013 – 2015 (Forecast)



Source: Local national banks, EIU

Real GDP data improved in 2014 in all nine countries in this Deloitte report, with the exception of Serbia. The substantial fall in real GDP in Serbia was triggered partly by a vis maior, as the country was hit hard by a severe flood in May 2014. The other eight countries posted an improvement in economic trends, driven mainly by the recovery of their principal trading partners and in domestic demand. Forecasts suggest that 2015 will not see recession in any of the nine countries, and average GDP growth is expected to be about two per cent.

The average real GDP growth in the nine countries was minus 0.4% in 2012, turning positive to plus 0.8% in 2013 and improving further to an 1.8% in 2014. This development was closely monitored by distressed investors who, recognising the economic turnround, have increased their activity in the CE region substantially in the past two years. This stronger investor interest has been matched by an increasing willingness of banks to sell (spurred on by a reduction in the pricing gap as a result of the additional provisionings triggered by the ECB's AQR exercise), and the NPL market has indeed gained momentum recently. A number of NPL transactions have been completed in the region, and many other distressed loan deals are currently ongoing.

> "Investor interest in distressed assets usually increases once the prospects for economic recovery become clear and uncertainty about the long-term value of assets subsides."

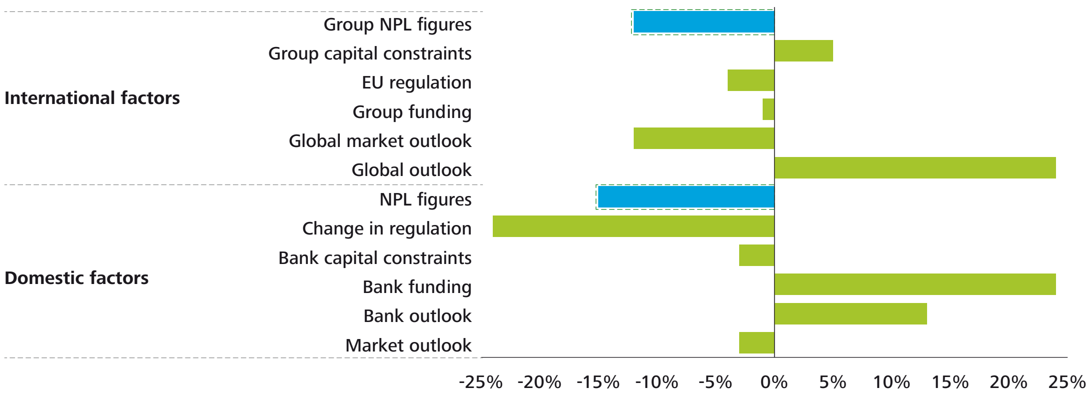
(ECB working paper, Resolving the legacy of non-performing exposures in euro area banks, May 2015)

With improved economic fundamentals and active portfolio cleaning via NPL disposals, the magnitude of the NPL problem lessened over the past year; however, it is still one of the two factors that significantly restrict credit supply and flows of credit into the economy, which would further propel economic growth. The European Investment Bank's CESEE Bank Lending Survey for the first half of 2015 (covering 14 countries, 15 international groups, 90 local banks, and approximately 50% of regional banking assets) reported that the still-high volumes of NPL and an unsupportive regulatory environment are the two main factors exerting a substantial negative effect on credit supply.

"NPLs and the regulatory environment, at both the domestic and group levels, are the main factors still adversely affecting supply conditions."

(EIB, CESEE Bank Lending Survey, H1 2015)

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 2015 CESEE Bank Lending Survey of the European Investment Bank

Although the negative effect of NPLs lessened over the past year, the hindering impact on credit supply is still susbtantial, meaning that the distressed debt sales market still has much to do. The second-largest negative factor is local regulation, mainly reflecting the fact that regulators have introduced measures (relating for example to the resolution and dismantling of excessive pre-crisis household FX lending) which have a detrimental effect on the profits of banks and so on their equity and capital adequacy position.

Some national banks have recommended tighter credit standards for retail loans. Banks would benefit from greater regulatory stability, as they cannot plan or decide their future strategic direction when there are many uncertainties about what the regulations will be.

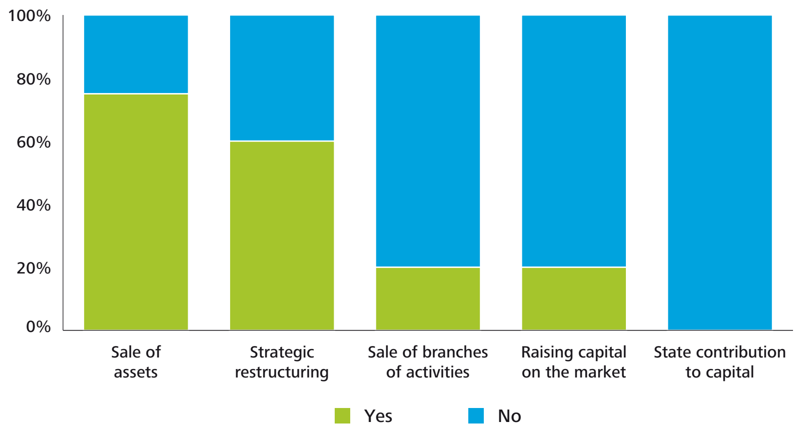
Although the regulatory environment as a whole does not seem supportive, policy makers' manner of handling NPL-related problems has been improving and specific measures have been taken in several CE countries. As an integral part of the NPL resolution process, the authorities need to (and recently have also tended to) ease the difficulties relating to NPL transactions. Transfers of credit contracts (with all rights and obligations, as well as collateral), client consents, licensing requirements, VAT and other tax burdens can make NPL transactions much more difficult and complicated than they need to be, and supportive legislation can simplify NPL deals enormously, providing a solid boost for the distressed debt sales market.

Debt sales market participants would indeed welcome regulatory support, as many deals are yet to be made. According to the EIB's CESEE Bank Lending Survey for H1 2015, deleveraging is ongoing, and cross-border banking groups continue to be engaged in various forms of restructuring to increase their group capital ratios. About 75% of banks in the survey indicated that they intend to strengthen their capital adequacy via asset sales. This implies a much greater willingness to sell, compared to the H1 2014 survey, as the corresponding proportion was around 60% in 2013.

"NPL resolution has moved to the top of policy makers' agenda, where NPL ratios are often high and negatively impact new credit and ultimately growth. Leaders in the region are actively looking for market-based solutions to clean up bank and corporate debtor balance sheets."

(Piroska Mohácsi Nagy, EBRD, Director for Country Strategy and Policy, NBH-EBRD NPL Workshop, March 2015, Budapest)

Figure 3. Strategic options to increase capital ratio



Source: H1 2015 CESEE Bank Lending Survey of the European Investment Bank

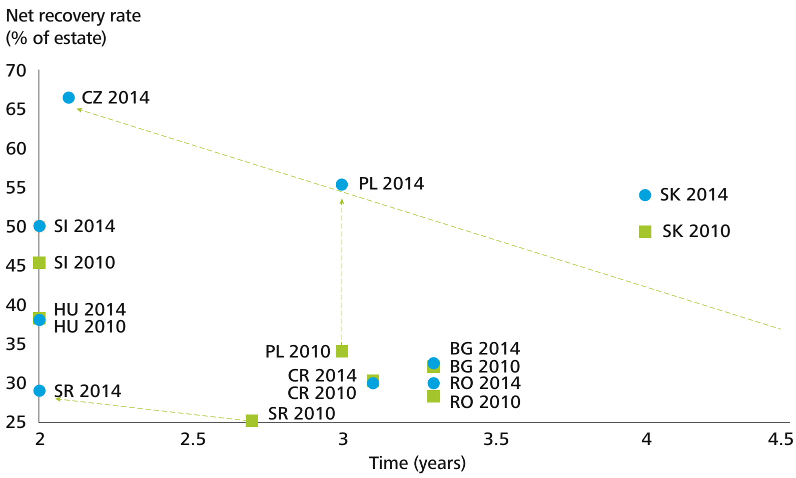
"Practice from euro area countries suggests that it can take up to three years to implement sufficiently strong improvements in banks' internal workout capacity for dealing with systemic NPE problems."

(ECB working paper, Resolving the legacy of non-performing exposures in euro area banks, May 2015)

Although more and more banks are engaging in NPL transactions, a number of banks still prefer an in-house NPL resolution. However, should such a bank have a higher NPL ratio, an internal workout can be cumbersome, consuming a significant amount of resources, such as capital held behind these soured assets, direct in-house resolution costs, time and substantial management effort. As recovery rates on collateralised exposures remained practically the same in 2014 compared to 2013, recovery expectations for banks have not improved. The same problems apply to investors in distressed loans, because they have distressed debt collection as a core activity. However they have the ability to be more flexible and efficient throughout the collection process, so that in general they tend to achieve substantially higher recovery rates.

As per net recovery rates, the average improvement in net recovery rates for the nine countries in this survey was a mere 0.8 percentage points in 2014 compared to 2013, driven mainly by 2.2 and 1.9 percentage point increases in Poland and Hungary respectively. Concerning the time for recovery, there were no improvements in 2014 in any of the nine countries.

Figure 4. Development of recovery conditions, 2010-2014



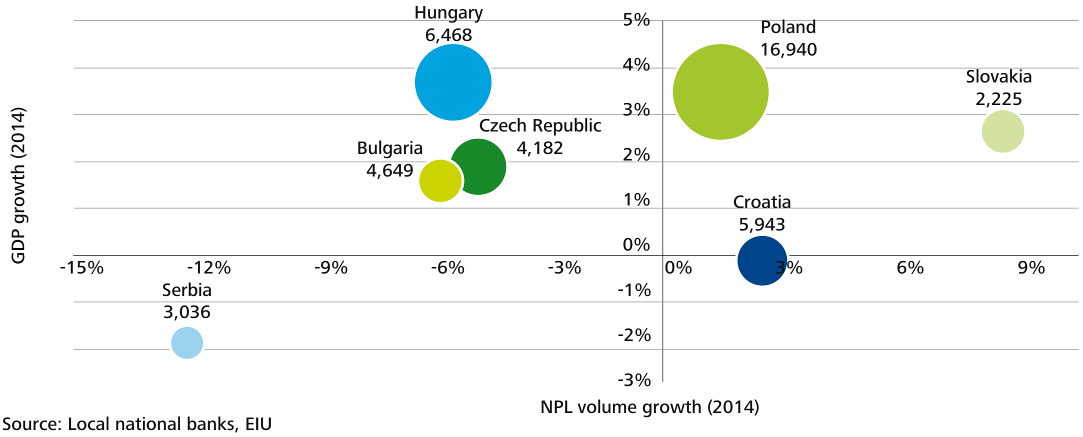
Source: World Bank
Note: CZ 2010 point is not displayed for illustrative reasons, as its time data is 6.5 years (net recovery rate is 20.9%).

"Besides these economic considerations, the acquisition of NPE portfolios by specialised investors is often held back by legal and regulatory impediments, which authorities should review as part of the NPE resolution process. Possible impediments in this respect may include rules for the transfer of credit contracts, licensing requirements for the type of companies involved and targeted tax (dis)incentives. Therefore, measures to support the development of an NPE market are of the utmost importance, in order to support the direct sale of selected NPE portfolios."

(ECB working paper, Resolving the legacy of non-performing exposures in euro area banks, May 2015)

Recent evolution of key NPL metrics

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

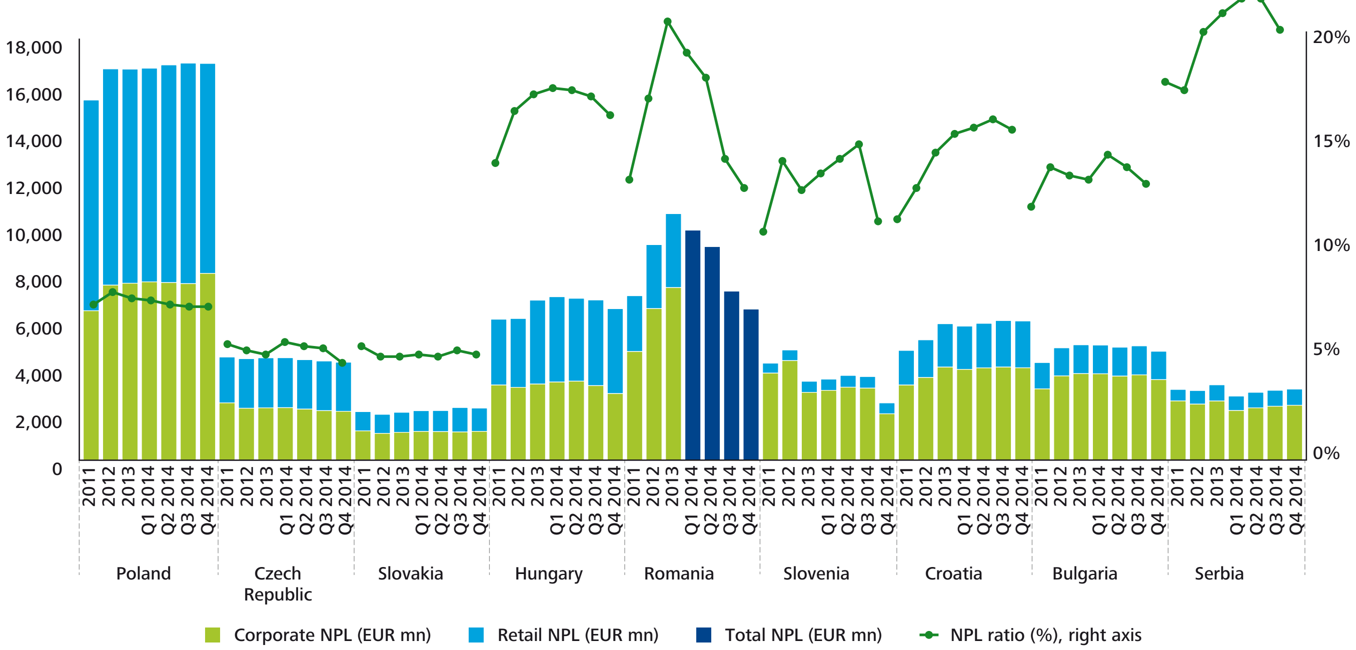


Source: Local national banks, EIU
Notes: Bubble size: Q4 2014 NPL volume (EURmn).
Slovenia and Romania are not presented in the chart as NPL volumes declined by 27% and 39%, respectively due to significant write-downs and NPL disposals.

With regard to the total NPL volume for the nine countries, 2014 was a turnaround year, as the total amount of NPL stock fell for the first time since 2011. Last year we reported a total of EUR 58.0bn NPL volume; this fell to EUR 52.3bn in 2014. This fall was driven mainly by significant NPL disposals and write-offs in Romania and Slovenia, where total NPL volumes were reduced by about EUR 4.1bn and EUR 0.9bn, respectively.

The Czech Republic, Serbia and Bulgaria also saw a fall in NPL volume, by EUR 0.2bn, EUR 0.2bn and EUR 0.3bn respectively. NPL volume remained at practically the same level in Hungary and Croatia, and increased in both Poland and Slovakia by EUR 0.2bn.

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



Source: National Banks, Deloitte analysis
Note: Only total NPL volumes were published in Romania in 2014 due to accelerated NPL disposals and write-offs
North region: PL, CZ, SK; South region: HU, RO, SI, CR, BG, SRB

A North–South divergence is visible in Figure 6. In Poland, the Czech Republic and Slovakia, NPL ratios are substantially lower than in the six Southern countries; therefore NPL resolution is less of an issue in these countries. However Poland and the Czech Republic possess substantial NPL volumes, which might attract distressed debt investors. The six countries of the Southern group have materially higher NPL ratios, although it seems that the peaks are behind us: portfolio cleaning and improvements in overall asset quality are taking place, with the active involvement of both sellers and buyers in the distressed debt market. In several countries, policy makers realised the urgent need for NPL resolution and have taken important steps to tackle the problem. The most significant changes can be observed in Romania and Slovenia.

In Romania large NPL deals and write-offs took place in 2014. In addition a change was introduced in March 2014 to the definition of the NPL ratio; however, a NPL still means 90+ days past due (DPD), and this change in methodology did not have a significant immediate effect on the total NPL ratio as quarterly NPL ratios were 20.4% in Q1 2014, 19.2% in Q2 2014, 15.3% in Q3 2014 and 13.9% in Q4 2014. Slovenia is also a focus country for NPL investors with multiple rumoured ongoing deals; however a significant fall in the NPL ratio in Q4 2014 compared to Q3 2014 was due to corporate NPL transfers from Abanka and Banka Celje to the national 'bad bank', the Bank Asset Management Company (BAMC), in October 2014. In addition, the corporate NPL ratio fell in Q4 2014 even without the effect of these transfers.

Table 1. NPL volumes and ratios, Q4 2014

EUR mn	Corporate	Corporate (%)	Retail	Retail (%)	Total	Total (%)
Poland	7,975	11.3%	8,964	6.5%	16,940	8.2%
Czech Republic	2,087	6.6%	2,095	4.7%	4,182	5.5%
Slovakia	1,230	8.5%	995	4.3%	2,225	5.9%
Hungary	2,844	15.6%	3,624	19.2%	6,468	17.4%
Romania	n/a	n/a	n/a	n/a	6,451	13.9%
Slovenia	1,981	17.7%	464	5.3%	2,445	12.3%
Croatia	3,945	30.7%	1,998	12.1%	5,943	16.7%
Bulgaria	3,438	20.0%	1,211	13.2%	4,649	14.1%
Serbia	2,344	29.0%	692	11.5%	3,037	21.5%
Total	**25,844**		**20,044**		**52,340**	

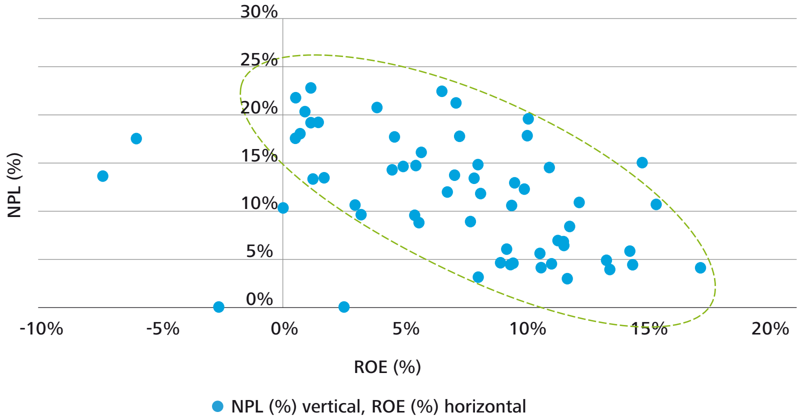
Source: National banks, Deloitte analysis
Note: Separate corporate and retail NPL ratios and volumes in Romania in 2014 are not displayed as figures have not yet been disclosed due to accelerated NPL disposals and write-offs

Looking at the individual banks in the region, Figure 7 gives an overview of the portfolio quality and profitability of the top ten banks in each of the nine countries in the study.

Figure 7 shows the logical negative correlation between NPL ratio and ROE. NPLs do not generate income, and as additional provisions are typically required, this adds to costs. Amongst the banks for which a NPL ratio was available, 65% have an NPL ratio above 10% and for 38% the ratio exceeds 15%. Excluding Poland, Slovakia and the Czech Republic from the analysis, where portfolios are less contaminated, and focusing on the remaining six countries, the asset quality is even worse. In these six countries, 87% of banks have a NPL ratio above 10% and for 54% the ratio exceeds 15%. The median level for the nine countries as a whole is 13.3%, whereas for the six Southern CE countries it is 15.8%. These high NPL ratios hinder the return to healthy lending and economic growth; therefore NPL problems must be addressed and resolved.

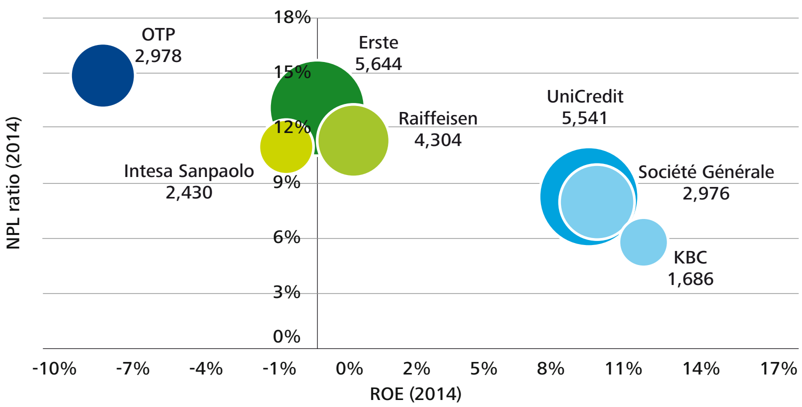
Figure 8 shows ROE and NPL data for the seven leading banking groups in the CE region; this also highlights the negative correlation between NPL ratio and ROE. These banking groups can be divided into two categories: four of them (OTP, Erste, Intesa, Raiffeisen) have NPL ratios above 10% with negative or slightly positive ROEs, while the remaining three (UniCredit, Société Générale, KBC) managed to keep their NPL ratios under 10% and ROEs around 10%. KBC preserved its leading position with a combination of the highest ROE and lowest NPL ratio among the seven banking groups. This is mainly attributable to the geographies of its subsidiaries: most of its assets are in the Czech Republic where the corporate NPL ratio is the lowest and retail NPL ratio is the second-lowest among the nine countries in the study. The OTP Group, which has a negative ROE and the highest NPL ratio, posted the worst performance among the seven banking groups. However, it should be noted that the profitability of the Hungarian banking sector, where OTP holds most of its assets, was hit hard by government measures in 2014, such as the reimbursement of former unilateral interest rate hikes and the formerly charged FX spreads in consumer loan agreements. In addition balance sheet clean-ups, reducing reported profits, also exerted a downward pressure on ROEs of banks in the Hungarian banking sector.

Figure 7. NPL ratio and ROE, top ten banks in the nine countries (2014)



Source: Banks' data disclosure, National banks, ECB CBD, ISI Emerging Markets
Note: Banks with NPL ratio above 30% or ROE below -10% are not displayed due to illustrative reasons. This means that 16 banks (of which six are Hungarian) are excluded, most of them with a ROE below minus 10%. NPL and ROE data were not available for 14 other banks. As a result, just 60 banks are shown here.

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



Source: Banks' data disclosure, ECB CBD, ISI Emerging Markets, Deloitte analysis
Notes: Bubble size: Q4 2014 NPL volume (EURmn)

Table 2 shows the NPL ratios and NPL volumes of the subsidiaries of each of the seven largest banking groups. The total volume of NPLs amounted to approximately EUR 26bn in 2014, a decrease from EUR 30bn in 2013. There were seven subsidiaries in these selected groups had NPL volumes in excess of one billion euros, two less than in 2013. The Polish group, Pekao, is one of these seven; however its high NPL volume stems from its large size rather than from a high NPL ratio.

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

UniCredit subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
PL	Pekao	27,557	6.8%	1,874
CZ	UniCredit CZ & SK	11,631	3.1%	361
CR	Zagrebacka Banka	7,611	19.6%	1,488
BG	UniCredit Bulbank	5,544	14.5%	804
RO	Unicredit Tiriac	4,200	9.6%	403
HU	UniCredit Bank Hungary	3,453	n/a	n/a
SI	UniCredit Banka	1,937	17.5%	340
SRB	UniCredit Banka	1,528	17.8%	272
	Total	**63,461**	**8.7%**	**5,541**

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

Société Générale subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
CZ	Komercní Banka	18,437	3.9%	719
RO	BRD	6,899	20.3%	1,400
CR	Splitska Banka	2,486	11.8%	293
PL	Eurobank	2,195	n/a	n/a
SI	SKB Banka	1,976	5.6%	110
BG	Soc. Gén. Expressbank	1,693	10.6%	179
SRB	Société Générale Banka	1,437	19.2%	275
	Total	**35,123**	**8.5%**	**2,976**

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

Erste Group subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
CZ	Ceska Sporitelna	17,314	4.4%	762
RO	BCR	8,871	23.0%	2,038
SK	Slovenska Sporitelna	8,217	5.8%	477
CR	Erste & Steiermärkische	4,440	20.7%	920
HU	Erste Bank Hungary	5,122	26.3%	1,345
SRB	Erste Bank	553	18.2%	101
	Total	**44,517**	**12.7%**	**5,644**

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

OTP Group subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
HU	OTP Hungary	8,726	17.5%	1,527
BG	DSK Bank	3,672	15.0%	551
HU	OTP Jelzálogbank	3,509	5.7%	198
CR	Otp Banka Hrvatska	1,482	13.3%	197
RO	OTP Bank Romania	1,383	17.8%	247
SK	OTP Banka Slovensko	1,171	10.3%	121
SRB	OTP Srbija	314	43.8%	137
	Total	**20,258**	**14.7%**	**2,978**

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

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

KBC subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
CZ	CSOB Group	15,944	4.1%	649
HU	K&H	5,100	13.6%	694
SK	Ceskoslovenska Obchodna	4,699	4.5%	214
BG	Cibank JSC	678	19.1%	129
	Total	**26,421**	**6.4%**	**1,686**

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

Intesa subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
SK	VUB	8,017	4.6%	369
CR	Privredna Banka Zagreb	5,161	13.4%	690
HU	CIB	3,500	21.8%	763
SRB	Banca Intesa	2,677	12.0%	320
SI	Banka Koper	1,739	10.6%	184
RO	Intesa Sanpaolo România	700	14.8%	104
	Total	**21,795**	**11.1%**	**2,430**

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

Raiffeisen subsidiaries in CE (2014, EUR mn)

	Bank name	Loans	NPL %	NPL vol.
PL	Raiffeisen Bank Polska	8,550	8.8%	750
SK	Tatra Banka	7,504	4.5%	337
CZ	Raiffeisen Bank	6,335	6.0%	381
HU	Raiffeisen Bank	4,714	25.7%	1,213
RO	Raiffeisen Bank	4,313	10.7%	460
CR	Raiffeisenbank Austria	3,200	14.8%	473
BG	Raiffeisen Bank	2,175	14.7%	320
SRB	Raiffeisen Banka	1,248	12.9%	161
SI	Raiffeisen Banka	825	25.2%	208
	Total	**38,864**	**11.1%**	**4,304**

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

Recent transaction activity

As already explained, given strong investor interest and an increasing propensity by banks to sell NPLs, NPL transaction activity gained momentum in 2014 and 2015. A number of deals are still ongoing, mainly transactions in Romania and Slovenia.

Many investors also focus specifically on Hungary: therefore NPL transactions may also occur there. The table below shows selected landmark transactions, but it is not comprehensive.

Table 3. Selected recently completed portfolio transactions

Date	Country	Seller	Buyer	Type of portfolio	PL or NPL?	Portfolio size (EUR mn)	Approx. price (EUR mn)	Deloitte involvement	Completed?
Sep-15	Hungary	Citibank	Erste	Retail	PL	Confidential	Confidential	Buy side financial advisor	Yes
Sep-15	Czech Republic	Citibank	Raiffeisen Bank	Retail	PL	Confidential	Confidential		Yes
May-15	Romania	Piraeus	Kruk	Retail, SME unsecured	NPL	200	Confidential	Sell side financial advisor	Yes
Mar-15	Slovenia	BAMC	BAML	Corporate loans	NPL	670	123		Yes
Dec-14	Romania	BCR	Deutsche Bank	Corporate loans	NPL	440	Confidential		Yes
Sep-14	Romania	Bank of Cyprus	Confidential	Corporate single case	PL	Confidential	95	Sell side legal advisor	Yes
Aug-14	Romania	MKB	Confidential	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
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
Source: Deloitte Intelligence

In addition to the completed transactions above, there were also portfolio deal attempts in 2015 that were not completed, mainly because of divergent price expectations. For example in Romania, Bank of Cyprus finally decided not to sell an EUR 545mn real estate NPL portfolio (Project Ariadne), despite already having a chosen bidder offering 20% of the gross exposure. Erste`s BCR, despite solid initial investor interest, also pulled a sale of a fairly heterogeneous EUR 2.7bn NPL portfolio (Project Neptune) consisting of CREs and large corporate NPLs, as well as retail exposures. In Hungary, MKB turned away from a sale of an EUR 760mn CRE PL and NPL portfolio (Project Danube) after having received bids, another example of a material pricing disconnect between banks and investors. These failed deals made investors more cautious, affecting their attitude and risk perception. Therefore further larger-scale successful deals are awaited to strengthen investors' confidence.

Investor preferences in the CE distressed debt sales market

Being a leading advisor in the CE distressed debt sales market, Deloitte has amassed substantial knowledge of distressed investors` preferences, in terms of targeted asset classes, geographies and investment size.

Investor preferences

- Trend. NPL markets are competitive in Western Europe, and international investors have a growing interest in CEE. Investors are aware that early stage acquisitions could help them dominate the market.
- Size. The typical ticket size is EUR 15-30 million for an international investor. Future deal flow is also key to them spending time and money researching the country.
- Strategy. Investors see CEE as a new market to enter and dominate. Investor focus is on Romania, Hungary and Slovenia.
- Asset type. Investors have their preferred specific asset types in the corporate/retail – secured/unsecured universe. Transaction volumes are dominated by secured corporate and unsecured retail exposures, as investors tend to see reputational risk in mortgage portfolios. In the corporate market segment, both SME NPL portfolios and large corporate single cases are attractive for investors.
- IRR. The typical expected unlevered IRR rate in the CEE market is 15-25%. These IRR expectations are substantially higher compared to Western European returns and are attributable to the markedly less developed CEE debt sales market, entailing higher risks and lower deal certainties.

Potential challenges

- Readiness of banks. Appropriate data quality and a sufficient provisioning level are key for investors.
- Collection process. Investors require a suitable collection service to manage the portfolio post acquisition.
- Collateral. Investors prefer office, retail or industrial assets rather than hotels and land, and require a suitable real estate valuation partner locally who can value the asset, comment on comparable transactions and advise on asset management strategies.
- Transaction process. Investors prefer a two-phase, well-prepared transaction process, including an indicative and a binding phase. Investors require well-prepared (VDD-type) documentation and a professionally managed process, in line with international standards. Investors will not enter a process that has too much competition (too many bidders) and prefer deals organised by internationally-experienced advisors.

Poland

Economic performance improved in Poland in 2014, with an increase of 3.7% in real GDP compared to growth of 1.5% in 2013. Poland's real GDP growth was propelled mostly by domestic demand, which derived from both consumption and investment. Inflation fell by one percentage point between 2013 and 2014, to 0.1%, mainly as a result of lower food and global energy prices. Thus there was practically no inflation in 2014, strengthening concerns about deflation. In previous years, unemployment increased in Poland, but 2014 was a turnaround year as the unemployment rate fell slightly by 1.2 percentage points to 12.3%. Both the budget deficit and public debt were reduced in 2014, to 1.7% and 43.6% respectively.

The volume of retail and corporate loans both grew substantially, by 6.1% and 8.2% respectively. Following modest lending growth in previous years, 2014 therefore saw some growth acceleration, particularly in the corporate segment.

The amount of the retail NPL stock contracted slightly by 1.9%, whereas corporate NPL volumes increased by 5.6%. However the NPL ratios for both retail and corporate loans fell slightly, to 6.5% and 11.3% respectively, on the back of lending growth and an active debt sales market. Corporate NPL volume growth is partially attributable to the fact that the corporate debt sales market is much less active than the retail NPL market. The total NPL volume in the Polish banking sector amounted to about PLN 72bn (EUR 16.9bn) as of end-2014.

Although CAR fell by 0.8% percentage points to 15.0%, this is still well above the regulatory minimum, although it is the lowest figure among the nine countries in this study. ROA virtually remained unchanged at 1.0%, whereas ROE decreased slightly by 0.7 percentage points to 9.5%. Both ROE and ROA in Poland are the third-highest among the nine countries (behind the Czech Republic and Slovakia), a reassuring indication of profitability. The cost/income ratio (CIR) was unchanged at 52.9%. The loans-to-deposits ratio (L/D) was 2.1% percentage points lower, at 104.8%. Although the banking sector has not yet achieved complete self-financing, the current L/D ratio is indicative of a banking sector with a healthy financing structure. The FX share of lending increased slightly, from 30.0% to 31.0%.

Table 4. Key metrics in Poland

Macro	2013	2014	Change (% point)
GDP (% real change pa)	1.5%	3.7%	2.2%
Consumer prices (% change pa)	1.1%	0.1%	-1.0%
Recorded unemployment (%)	13.5%	12.3%	-1.2%
Budget balance (% of GDP)	-2.6%	-1.7%	0.9%
Public debt (% of GDP)	49.8%	43.6%	-6.2%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (PLN mn)	552,401	585,933	6.1%
Corporate loans (PLN mn)	277,960	300,886	8.2%
NPL volumes			
Retail NPLs (PLN mn)	39,065	38,306	-1.9%
Corporate NPLs (PLN mn)	32,280	34,080	5.6%
NPL ratios			
Retail NPL ratio (%)	7.1%	6.5%	-0.6%
Corporate NPL ratio (%)	11.6%	11.3%	-0.3%
Key ratios			
CAR (%)	15.8%	15.0%	-0.8%
ROE (%)	10.2%	9.5%	-0.7%
ROA (%)	1.1%	1.0%	-0.1%
CIR (%)	52.9%	52.9%	0.0%
L/D (%)	106.9%	104.8%	-2.1%
FX share of lending (%)	30.0%	31.0%	1.0%

Source: EIU, NBP, ECB CBD

In January 2015, the decision by the Swiss National Bank (SNB) to change its exchange rate policy by reintroducing a floating EUR/CHF rate and abandoning the formerly-defended rate of 1.2 resulted in an appreciation of the Swiss Franc against many major currencies, including the Polish zloty. The strong appreciation of the Franc could have triggered a considerable deterioration in asset quality in Poland, as the share of FX-denominated housing loans (of which the majority was CHF-denominated) amounted to 19.2% of total loans to the non-financial sector at the end of 2014. However, a reduction in the CHF LIBOR rates and the favorable Polish macroeconomic environment (rising wages, falling rate of inflation) mitigated the negative impact, causing only a moderate decline in asset quality. Consequently the total amount of retail and coporate NPLs increased by 3.5% in the first half of 2015.

Table 5. Top players in the Polish banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol	Major owner
1	PKO	57,194	39,719	6,476	722	1.3%	11.1%	6.9%	2,741	State
2	Pekao	38,555	27,557	5,487	625	1.6%	11.4%	6.8%	1,874	UniCredit
3	BZ WBK	28,533	18,622	4,015	468	1.6%	11.7%	8.4%	1,559	Santander
4	mBank	26,655	17,225	2,410	275	1.0%	11.4%	6.4%	1,102	Commerzbank
5	ING BSK	22,699	13,941	2,405	251	1.1%	10.4%	4.1%	572	ING
6	Getin Noble	15,860	11,357	1,127	76	0.5%	6.7%	13.7%	1,556	Leszek Czarnecki
7	Millennium	14,191	10,648	1,255	145	1.0%	11.6%	3.0%	314	BCP
8	Raiffeisen	12,558	8,550	1,416	74	0.6%	5.2%	8.8%	750	Raiffeisen
9	BGK	12,020	4,206	2,240	102	0.8%	4.6%	14.6%	614	State
10	Citibank	11,638	3,310	1,724	228	2.0%	13.2%	4.9%	161	Citibank
	Banking sector total	**360,761**	**207,530**	**38,981**	**3,702**	**1.0%**	**9.5%**	**8.2%**	**16,940**	

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

The overall NPL ratio for the banking sector in Poland declined by 0.4% percentage points, from 8.6% to 8.2% between 2013 and 2014, which is the third-lowest among the nine countries in the study, behind Slovakia and the Czech Republic. Only two banks, Getin Noble and BGK, have NPL ratios above 10%, while Millenium has a very low NPL ratio of 3.0%. Asset concentration among the top ten banks in Poland is the lowest among the nine countries. The top three, five and ten banks account for 34%, 48%, 67% of total banking assets respectively. The corresponding averages for the nine countries in total are 42%, 56% and 77%. The largest bank is PKO, with a market share of 15.9%, followed by Pekao and BZ WBK, accounting for 10.7% and 7.9% of total banking assets respectively. Equity concentration, at 41%, 53% and 73% for the top three, five and ten Polish banks, is less than the regional averages of 46%, 60% and 79%. Poland is the only country out of the nine in the study where all top five banks have ROE above 10%. Additionally, it should be noted that among the nine countries, only in Poland and the Czech Republic have the top ten banks remained profitable. Seven of the top ten banks are foreign-owned: PKO and BGK are controlled by the state and Getin Noble is in private individual ownership.

The Polish banking sector could face significant extra burdens from 2016 as the new government announced higher taxation on banks than had been expected. Instead of the anticipated PLN 5bn per year, the government plan forecasts PLN 6-6.5bn in tax per year on Polish banks. In addition, to cover the failure of SK Bank (one of the smaller players of the Polish banking sector) an extra levy will be imposed on Polish credit institutions, which is expected to amount to PLN 1.4bn. Unless the banks pass on the extra levy to their customers, the new measures could have a negative impact on the profitability of the banking sector.

Debt sales market in Poland

The debt sales market in Poland showed improvement in 2014. As in 2013, the retail market was on an improving trend, as in addition to the already active consumer NPL market segment, some deal activity could also be seen in the mortgage NPL segment. Sales of corporate NPLs also crept higher, only moderately though.

The nominal value of consumer (PLN 11.7bn) and mortgage (PLN 1.7bn) NPL portfolios offered for sale totalled PLN 13.4bn in 2014, and were sold at an average price of 15%. Compared to 2013, this implies an increase of about 25% in terms of face value of the consumer NPLs sold, having risen from PLN 9.4bn to PLN 11.7bn. Last year we reported that the mortgage NPL market was virtually non-existent; this situation changed in 2014 and PLN 1.7bn mortgage NPLs were transacted. The fact that this formerly non-existent market segment showed signs of awakening activity in 2014 fuels expectations of future growth in the debt sales market in Poland. The leading investor in the Polish debt purchase market, Kruk, has disclosed figures for mortgage NPL purchases. Kruk invested in a portfolio purchased from Getin Noble with nominal value of PLN 710mn and in a portfolio sold by BZ WBK with a nominal value of PLN 443mn. Increases in average sales prices, from 11% to 15%, were attributable mainly to the fact that mortgages are collateralised with real estate, in contrast to unsecured consumer loan exposures.

Table 6. Polish consumer and mortgage-backed debt market

PLN bn	Portfolios offered for sale*	Average prices
2014	13.4	15%
2013	9.4	11%

*Face value
Source: Kruk

Table 7. Polish corporate debt market

PLN bn	Portfolios offered for sale*	Average prices
2014	2.0	6%
2013	1.8	4%

*Face value
Source: Kruk

The stagnation in corporate debt sales continued in 2014 due to unwillingness of banks to sell corporate NPLs. The nominal value of corporate NPL portfolios offered for sale increased slightly in 2014 from PLN 1.8bn to PLN 2.0bn and the average sale price also gained by two percentage points to 6%. These compressed prices, relative to average sales prices in the consumer debt market, are due to the fact that banks have resorted to corporate NPL disposals only in case of the most distressed loans, where they see no other viable alternative, as well as the fact that in the case of corporate NPLs:

- 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 significantly.

These characteristics of corporate NPLs result in higher servicing and third party expenses than is the case with retail NPLs.

Czech Republic

After the recession in 2013, real GDP increased by 2.0% in 2014 on the back of recovery in both external and domestic demand, as well as easy monetary conditions. Although the unemployment rate remained unchanged at 7.7% in 2014, it is expected to fall in 2015, due to continuing economic recovery. Inflation was 1.1 percentage points lower at 0.4% due to the fall in global energy prices, giving rise to fears about deflation. The budget deficit increased by 0.5% points to 1.9%, while public debt as a percentage of GDP amounted to 43.3%, a decrease from 46.0% in 2013.

Retail and corporate loan volumes both grew at a moderate pace in 2014, by 4.0% and 0.9% respectively. Loan growth was accompanied by a modest decrease in NPL stocks. Corporate NPL volumes fell by 6.6%, and retail NPL volumes by 1.8%, so that the total NPL volume as of end-2014 was about CZK 116bn. Retail and corporate NPL ratios were both slightly lower, falling by 0.3 and 0.5 percentage points respectively. As in 2013, 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. Asset quality in the Czech Republic is therefore among the best in the CE compared region.

CAR has been gradually improving in recent years, and the ratio reached 17.8% in 2014, indicating a well-capitalised banking sector. Despite the low interest rate environment, Czech banks improved their profitability in 2014: ROE increased to 16.6% while ROA improved by 0.4 percentage points. The profitability of the Czech banking sector is the highest among the nine countries in the study. Although the cost/income ratio rose by 4.7 percentage points, it is still the highest operating efficiency among all other countries in the study. The L/D ratio increased by 1.3 points to 76.7% but is still the lowest among the nine countries: this is an attractive feature of the Czech banking market for international banking groups in times of funding scarcity. Deposits continued to increase in 2014, although at a slower pace than in previous years. The FX share of lending increased by one percentage point to 19%; however it is still the lowest amongst the non-Euro analysed countries.

Table 8. Key metrics in the Czech Republic

Macro	2013	2014	Change (% point)
GDP (% real change pa)	-0.9%	2.0%	2.9% 🟢
Consumer prices (% change pa)	1.4%	0.4%	-1.1% 🔴
Recorded unemployment (%)	7.7%	7.7%	0.0% ⚫
Budget balance (% of GDP)	-1.4%	-1.9%	-0.5% 🔴
Public debt (% of GDP)	46.0%	43.3%	-2.7% 🟢
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (CZK mn)	1,180,731	1,228,149	4.0% 🟢
Corporate loans (CZK mn)	867,135	874,855	0.9% 🟢
NPL volumes			
Retail NPLs (CZK mn)	59,179	58,116	-1.8% 🟢
Corporate NPLs (CZK mn)	61,990	57,873	-6.6% 🟢
NPL ratios			
Retail NPL ratio (%)	5.0%	4.7%	-0.3% 🟢
Corporate NPL ratio (%)	7.1%	6.6%	-0.5% 🟢
Key ratios			
CAR (%)	17.3%	17.8%	0.5% 🟢
ROE (%)	13.7%	16.6%	2.9% 🟢
ROA (%)	1.3%	1.7%	0.4% 🟢
CIR (%)	43.0%	47.7%	4.7% 🔴
L/D (%)	75.4%	76.7%	1.3% 🔴
FX share of lending (%)	18.0%	19.0%	1.0% 🔴

Source: EIU, CNB, ECB CBD

Table 9. Top players in the Czech banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	Komercní Banka	31,102	18,437	3,448	461	1.5%	13.4%	3.9%	719	Société Générale
2	Ceska Sporitelna	30,456	17,314	3,724	534	1.8%	14.3%	4.4%	762	Erste
3	CSOB	30,384	15,944	2,762	476	1.6%	17.2%	4.1%	649	KBC
4	UniCredit CZ & SK	13,410	11,631	2,028	157	1.2%	7.8%	3.1%	361	UniCredit
5	Raiffeisen Bank	8,148	6,335	825	74	0.9%	9.0%	6.0%	381	Raiffeisen
6	Hypotechni Banka	8,016	n/a	1,104	111	1.4%	10.1%	n/a	n/a	KBC
7	Ceskomoravska Stavebni	5,949	n/a	355	42	0.7%	11.8%	n/a	n/a	KBC
8	GE Money Bank	5,207	4,186	1,502	146	2.8%	9.7%	12.2%	513	GE Capital
9	ING Bank	4,809	n/a	FB	12	0.2%	n/a	n/a	n/a	ING
10	CMZRB	4,590	486	169	9	0.2%	5.3%	16.1%	78	State
	Banking sector total	**181,712**	**75,825**	**18,129**	**3,009**	**1.7%**	**16.6%**	**5.5%**	**4,182**	

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

As the table shows, the Czech banking sector is in very good shape, having both the highest profitability and the lowest NPL ratio among the nine countries examined. Only three banks Raiffeisen Bank with 6.0%, GE Money Bank with 12.2% and CMZRB with 16.1%, have NPL ratios higher than that of the overall banking sector average (5.5%). None of the top three banks have NPL ratios above the average. Asset concentration in the top three, five and ten Czech banks is slightly higher than the average for the nine countries, at 51%, 63% and 78% respectively. Equity concentration among the country's top three banks (55%) is the second-highest in the region, behind Croatia, and for the top five and ten banks is somewhat below the regional average, at 59% and 77% respectively. The top three market players can be differentiated from the other banks, as there is a considerable gap between the third and fourth bank with regard to market share based on assets. Komercní Banka has a market share of 17.1%, followed by Ceska Sporitelna and CSOB with 16.8% and 16.7% respectively. The fourth player, UniCredit CZ & SK, has only a 7.4% share of total assets. Most of the top ten Czech banks have foreign owners: nine out of the top ten players are foreign-owned, and only the tenth (CMZRB) is 100% owned by the state.

Debt sales market in the Czech Republic

Table 10. Czech and Slovak consumer debt market

EUR bn	Portfolios offered for sale*	Average prices
2014	0.2	19%
2013	0.4	21%

*Face value
Source: Kruk

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 nominal value of consumer loans offered for sale in the Czech Republic and Slovakia combined decreased further from an already relatively low base of EUR 400mn in 2013 to EUR 200mn in 2014. On the other hand, transactions were closed at a higher average price in comparison with Poland and Romania, mainly due to high achievable recovery rates, as well as limited supply stemming from lower NPL volumes. Activity in the mortgage debt sales market is sluggish, as the propensity of banks to sell these types of assets is fairly low. Corporate loans are usually sold privately to a pre-selected group of investors, without an open tender. Another reason for the smaller Czech debt sales market is that debt collection outsourcing predominates over asset disposals.

Slovakia

Economic conditions in Slovakia improved further in 2014, with a 2.4% increase in real GDP. The main drivers of real GDP growth were recovery in household consumption and investment demand. Despite accelerating GDP growth, prices fell by 1.5% points due to lower global commodity prices, resulting in deflation of minus 0.1%. On the back of GDP growth, unemployment fell by 1.3% points, but is still high relative to the other countries in this study (only Serbia and Croatia have higher unemployment rates.) The budget deficit increased slightly in 2014, but remained below the 3% Maastricht criterion. Public debt increased slightly; however at 57% of GDP it is still at a manageable level.

Growth in retail loans in 2014 accelerated to 12.2%. This increase was driven mainly by mortgage loans, but there was also growth in consumer loan volumes. In contrast, corporate loan volumes shrank slightly by 1.5%, although at a slower pace than in previous years. Both retail and corporate NPL volumes increased by 16.6% and 3.4% respectively, although from a relatively low base. The increase in retail NPL volumes is due mainly to the steady 12.2% growth in retail lending. Although the NPL ratio for retail loans increased slightly by 0.2 points to 4.3%, this is still the lowest level out of the nine countries in this study. The corporate NPL ratio rose further in 2014; this was attributable to the contraction in corporate lending. Nevertheless the corporate NPL ratio is still the second-lowest among the nine countries, behind the Czech Republic.

CAR rose by 0.8% points to 17.4%, demonstrating sound shock-absorbing capacity of the Slovak banking sector. ROA was 1.2% slightly higher than in 2013. Despite the low interest rate environment and relatively high competition in the banking sector, ROE increased by 2.4 points to 10.3%, the second-highest return behind the Czech Republic. CIR rose moderately by 0.6 points to 56.6%, which is around the average for the nine countries. The L/D ratio fell by 3.6 points to 91.1%. The FX share of total lending is not an issue, since the euro is the national currency.

Table 11. Key metrics in Slovakia

Macro	2013	2014	Change (% point)
GDP (% real change pa)	0.9%	2.4%	1.5% ●
Consumer prices (% change pa)	1.4%	-0.1%	-1.5% ●
Recorded unemployment (%)	14.1%	12.8%	-1.3% ●
Budget balance (% of GDP)	-2.8%	-2.9%	-0.1% ●
Public debt (% of GDP)	55.4%	57.0%	1.6% ●
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (EUR mn)	20,534	23,036	12.2% ●
Corporate loans (EUR mn)	14,612	14,389	-1.5% ●
NPL volumes			
Retail NPLs (EUR mn)	854	995	16.6% ●
Corporate NPLs (EUR mn)	1,189	1,230	3.4% ●
NPL ratios			
Retail NPL ratio (%)	4.2%	4.3%	0.2% ●
Corporate NPL ratio (%)	8.1%	8.5%	0.4% ●
Key ratios			
CAR (%)	16.6%	17.4%	0.8% ●
ROE (%)	7.9%	10.3%	2.4% ●
ROA (%)	0.9%	1.2%	0.3% ●
CIR (%)	56.0%	56.6%	0.6% ●
L/D (%)	94.7%	91.1%	-3.6% ●
FX share of lending (%)	1.0%	0.9%	-0.1% ●

Source: EIU, NBS, ECB CBD

Table 12. Top players in the Slovak banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol	Major owner
1	Slovenska Sporitelna	12,943	8,217	1,273	181	1.4%	14.2%	5.8%	477	Erste
2	VUB	11,175	8,017	1,287	112	1.0%	8.7%	4.6%	369	Intesa Sanpaolo
3	Tatra Banka	9,664	7,504	956	104	1.1%	10.9%	4.5%	337	Raiffeisen
4	Ceskoslovenska Obchodna	5,987	4,699	649	60	1.0%	9.2%	4.5%	214	KBC
5	UniCredit CZ & SK*	4,203	2,238	566	42	n/a	7.4%	8.9%	199	UniCredit
6	Postova Banka	4,000	n/a	n/a	n/a	1.8%	n/a	n/a	n/a	J&T Finance
7	Prva Stavebna Sporitelna	2,640	1,994	241	22	0.8%	9.1%	4.4%	88	Schwäbisch Hall
8	Sberbank Slovensko	2,023	1,661	218	11	0.5%	5.0%	9.5%	158	Sberbank
9	Prima Banka Slovensko	1,912	n/a	125	1	0.1%	0.8%	n/a	N/A	Penta Investments
10	OTP Banka Slovensko	1,467	1,171	108	0	0.0%	0.0%	10.3%	121	OTP
	Banking sector total	**62,456**	**37,425**	**7,410**	**763**	**1.2%**	**10.3%**	**5.9%**	**2,225**	

*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

Among the top ten banks, only OTP Banka Slovensko has a NPL ratio above 10.0%, although Sberbank Slovensko and Postova Banka have relatively high NPL ratios of 9.5% and 8.9% respectively. Prva Stavebna Sporitelna has the lowest NPL ratio, 4.4%; this is slightly below those for Tatra Banka (4.5%), VUB (4.6%) and Ceskoslovenska Obchodna (4.5%). The most profitable bank is the market leader, Slovenska Sporitelna, with ROE of 14.2%. The third-largest bank, Tatra Banka, also outperformed the average ROE for the banking sector, with ROE of 10.9%. There was no loss-making bank in 2014 among the top ten banks in Slovakia. Asset concentration in Slovakia is the highest among the nine countries in the study: the top three, five and ten banks account for 54%, 70% and 90% of total banking assets respectively. Equity concentration for the top three, five and ten banks, at 48%, 64% and 73% respectively, are closer to the regional averages. The averages in the region are: 46%, 60% and 79%. The three largest banks are Slovenska Sporitelna, VUB and Tatra Banka, with market shares based on assets amounting to 20.7%, 17.9% and 15.5% respectively. The top ten banks in Slovakia are predominantly foreign-owned: nine are controlled by foreign entities and only Postova Banka is in domestic private ownership. (J&T Finance is controlled by Jozef and Patrik Tkac and Ivan Jakabovic.) A recent development is that Sberbank Slovensko was acquired by Penta Investments in December 2015.

Debt sales market in Slovakia

Table 13. Czech and Slovak consumer debt market

EUR bn	Portfolios offered for sale*	Average prices
2014	0.2	19%
2013	0.4	21%

*Face value
Source: Kruk

Investors 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. In 2014, the nominal value of consumer loans offered for sale in the two countries fell to EUR 200mn from an already relatively low base of EUR 400mn in the previous year. On the other hand, the transactions were closed at a higher average price compared to Poland and Romania, due mainly to high achievable recovery rates, as well as the limited supply stemming from lower NPL volumes.

Hungary

Economic recovery continued in Hungary in 2014. Real GDP grew by 3.6%, driven mainly by increasing domestic demand fuelled by both investment and gradually-improving household consumption. Domestic investment activity was due to an increase in demand, spurred by the utilisation of EU funds and the Funding for Growth Scheme (FGS) implemented by the National Bank of Hungary (NBH). Unemployment fell by 1.2 points to 7.9%. Hungary slid into deflation in 2014, due mainly to lower fuel and food prices. The budget deficit increased slightly by 0.5 points to 2.8%. Public debt as a percentage of GDP fell to 76.9%; however this is still the second-highest level among the nine countries in this study.

The volume of retail loans decreased slightly by 0.7% in 2014. Although the repayment of FX loans affected lending growth negatively, new HUF housing lending gained some momentum. In 2013 there was a turnaround on corporate loan volumes, which had previously been shrinking; and volumes grew by 11.2%, driven mainly by the NBH's FGS which aims to provide cheap funding for SMEs. However, there was only a small further increase of just 0.2% in 2014. At the beginning of 2015, the FGS Plus programme was launched by the NBH to promote further credit activity among SMEs, which had previously been excluded from the original FGS programme, due to their higher credit risk profile.

Retail NPL stocks increased slightly by 1.2%, but corporate NPL volumes fell substantially by 12.5% for reasons explained below. The retail NPL ratio increased further to upwards a peak level in recent years of 19.2%; this is the highest figure out of the nine countries in the study. Reducing mortgage NPL volumes from banking balance sheets by a significant amount is difficult, as there is practically no mortgage NPL market (mostly due to high reputational risks), except for the purchases of debtors' real estates by Hungarian National Asset Management Inc. (HNAM).

Table 14. Key metrics in Hungary

Macro	2013	2014	Change (% point)
GDP (% real change pa)	1.1%	3.6%	2.5%
Consumer prices (% change pa)	1.7%	-0.2%	-1.9%
Recorded unemployment (%)	9.1%	7.9%	-1.2%
Budget balance (% of GDP)	-2.3%	-2.8%	-0.5%
Public debt (% of GDP)	79.2%	76.9%	-2.3%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (HUF bn)	6,002	5,963	-0.7%
Corporate loans (HUF bn)	5,734	5,745	0.2%
NPL volumes			
Retail NPLs (HUF bn)	1,130	1,143	1.2%
Corporate NPLs (HUF bn)	1,025	898	-12.5%
NPL ratios			
Retail NPL ratio (%)	18.8%	19.2%	0.3%
Corporate NPL ratio (%)	17.9%	15.6%	-2.3%
Key ratios			
CAR (%)	17.4%	17.0%	-0.4%
ROE (%)	2.2%	-17.5%	-19.7%
ROA (%)	0.2%	-1.6%	-1.8%
CIR (%)	65.9%	65.7%	-0.2%
L/D (%)	114.2%	107.0%	-7.2%
FX share of lending (%)	51.0%	51.0%	0.0%

Source: EIU, NBH, ECB CBD

On the other hand, the corporate NPL ratio fell by 2.3 points to 15.6%, due mainly to a one-off transaction between a parent company and its Hungarian subsidiary, in which non-performing assets were transferred to the parent company's balance sheet. The most acute NPL problem in the corporate sector is the high level of project finance NPLs (mainly CRE NPLs), accounting for 40.0% of the total volume of corporate NPLs. The sale of project finance NPLs contributed to the reduction in the corporate NPL ratio; however these were predominantly intra-group transactions, and not market deals. A step towards the market-based resolution of project finance NPLs would be if the Hungarian Restructuring and Debt Management Company (MARK), which was established by the NBH in November 2014, were to purchase these portfolios from Hungarian banks. Corporate NPL stocks are expected to decrease significantly from 2016, as MARK is expected to start buying project finance NPLs and repossessed real estates at market prices by the end of 2015. Previously, CIB, Raiffeisen, Erste and MKB have been the most active in project financing, and the largest transactions might therefore be expected with them. In addition, several open market corporate NPL deals are rumoured, which also suggests a pickup in the Hungarian corporate debt sales market.

CAR decreased slightly by 0.4 points to 17.0%, but this still indicates an adequately capitalised banking sector; the parent companies compensated for the banks' losses through capital injections.

Besides Romania and Slovenia, only Hungary had negative profitability ratios in 2014 out of the nine countries in the study. ROE fell to minus 17.5% and the ROA to minus 1.6% (the worst among the nine countries in terms of both ROE and ROA). This is largely due to the Settlement Act, which damaged the profitability of the Hungarian banking sector in 2014. The Settlement Act consists of three pillars: (1) reimbursement of former unilateral interest rate hikes in consumer loan agreements which were deemed unfair by the Curia of Hungary (Hungarian Supreme Court); (2) reimbursement of formerly charged FX spreads in consumer loan agreements, also deemed unfair by the Curia; and (3) conversion of FX mortgage loans to HUF, which however did not trigger any immediate losses as conversion was carried at market rates. These three pillars resulted in a loss of about EUR 1.9bn for the banking sector in 2014.

In addition, as clients with existing contracts received reimbursement via massive reductions in their outstanding loans in 2015, the Act will also have a substantial negative impact on the profitability of banks in 2015. The government of Hungary and the EBRD signed a Memorandum of Understanding (MoU) at the beginning of 2015, which could bring some relief to the Hungarian banking sector. The government has also agreed to a gradual reduction in the bank levy in forthcoming years. The bank levy will be calculated on modified total assets as at the end of 2014, instead of modified total assets as at the end of 2009. In addition, the tax burden will be reduced from 0.53% recently to 0.31% in 2016, and 0.21% from the beginning of 2017, and eventually (from 2019) it will be aligned with prevailing EU norms. The government of Hungary also promised to refrain from implementing any new measures that could adversely affect the profitability of the banking sector. However the consequences of the brokerage scandals uncovered at the beginning of 2015 will put an extra burden on the market, since banks will have to pay additional fees to the Deposit Insurance Fund (OBA) and Investor Protection Fund (BEVA) in forthcoming years. These Funds must compensate investors for the losses they suffered as a result of the collapse of the three brokerages. These investment companies could not account for clients' cash, or issued bonds without permission, according to the NBH. Additionally, the parliament has recently approved the conversion of FX-denominated auto loans to HUF at preferential rates, triggering additional losses for banks and leasing companies, especially in case of CHF contracts.

CIR at 65.7% is the highest among the nine countries. The L/D ratio fell substantially by 7.2 percentage points; however it is still above 100% and is the second-highest figure, behind Serbia. The FX share of lending remained unchanged at 51%.

Table 15. Top players in the Hungarian banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	OTP	23,945	8,726	3,458	-236	-1.0%	-6.8%	17.5%	1,527	Private & corp. entities
2	K&H	7,901	5,100	569	-47	-0.6%	-8.3%	13.6%	694	KBC
3	UniCredit	7,085	3,453	705	51	0.7%	7.2%	n/a	n/a	UniCredit
4	Raiffeisen	6,616	4,714	318	-373	-5.6%	-117.3%	25.7%	1,213	Raiffeisen
5	Erste	6,143	5,122	581	-293	-4.8%	-50.4%	26.3%	1,345	Erste
6	MKB	6,126	4,509	587	-137	-2.2%	-23.3%	23.4%	1,055	State
7	CIB	5,494	3,500	586	-329	-6.0%	-56.1%	21.8%	763	Intesa Sanpaolo
8	OTP Jelzálogbank	4,088	3,509	145	-247	-6.0%	-170.3%	5.7%	198	OTP
9	Magyar Fejlesztési Bank	3,436	n/a	656	3	0.1%	0.5%	n/a	n/a	State
10	Budapest Bank	2,751	2,045	358	-65	-2.4%	-18.2%	16.4%	336	State
	Banking sector total	**101,235**	**37,106**	**9,284**	**-1,625**	**-1.6%**	**-17.5%**	**17.4%**	**6,468**	

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

Only two banks in the top ten were profitable in 2014, UniCredit and Magyar Fejlesztési Bank (MFB). It should be noted however that MFB, being a special-purpose state-owned bank, is not affected by the Settlement Act as it does not have retail customers. As in 2013, CIB, Raiffeisen, MKB and Erste all reported losses in 2014. OTP, K&H, OTP Jelzálogbank and Budapest Bank were profitable in 2013, but their results turned negative in 2014 as a consequence of the Settlement Act. The market leader, OTP, had never reported losses prior to 2014. Five of the top ten banks have NPL ratios higher than the country average (17.4%). Excluding OTP Jelzálogbank, OTP's mortgage bank, K&H has the lowest NPL ratio (13.6%), while Erste has the highest (26.3%), closely followed by Raiffeisen (25.7%).
CIB managed to cut its NPL ratio from 37.3% in 2013 to 21.8% in 2014, due to special efforts.
Asset concentration among the top banks in Hungary is under to the average for the nine countries. The market share of top three, five and ten banks account for 39%, 51% and 73% of total banking assets. On the other hand, equity concentration for the top three, five and ten banks exceeded the regional average, at 51%, 61% and 86% respectively. The corresponding proportions for the regional averages are 46%, 60% and 79% respectively. As mentioned previously, the market leader is OTP with an asset-based market share of 23.7%, followed by K&H with 7.8%, and the third-largest bank is UniCredit with a market share of 7.0%. Five of the top ten banks have domestic ownership.

The number of state-owned banks increased to three with the recent acquisition of Budapest Bank from GE Capital in June 2015. This is in accordance with the Hungarian government's aim of reducing the market share of foreign-owned banks. However, according to the Memorandum of Understanding (MoU), the government is committed not to purchase any further majority stakes in systemically important domestic banks, and will privatise MKB and Budapest Bank within the next three years. State influence over the Hungarian banking sector may increase further with the purchase of a 15% stake in Erste Bank Hungary by the state, with EBRD also buying 15%. It was also announced in June 2015 that Erste had acquired the Hungarian retail portfolio of Citibank.

Romania

The Romanian economy continued to grow in 2014, although at a slower pace than in 2013. The increase in real GDP was propelled mainly by rising domestic demand. Inflation fell significantly, from 4.0% to 1.1%. Unemployment also fell to 6.8%, which is the lowest rate amongst the nine countries in the study. The budget deficit narrowed to 1.9%, compared to 2.5% in 2013. Although public debt as a percentage of GDP rose slightly, it remains lower than the 46% average for the nine countries.

The Romanian banking system witnessed a moderate decline in both retail and corporate loan volumes in 2014, for two main reasons. First, as a result of accelerated balance sheet clean-ups recommended by the National Bank of Romania (NBR), a large proportion of non-performing loans were sold or written-off. Second, in contrast to the decline in foreign currency lending, RON-denominated lending was stimulated by lower financing costs and a reduction in the mimimum requlatory reserve requirements, as well as the 'First Home' programme which helped increase the rate of growth in RON-denominated housing loans.

Due to the increase in disposals of distressed assets from banks' balance sheets and ongoing NPL transactions, separate corporate and retail NPL ratios and volumes for 2014 have not yet been disclosed by the NBR. However, the total NPL ratio has been disclosed; this fell from 21.9% in 2013 to 13.9% in 2014, due to NPL disposals and increased write-offs of non-performing loans. It should be noted however that in March 2014, the NBR changed the methodology for determining the NPL ratio. Since then, the NPL ratio has been calculated from prudential reports submitted by banks. However, a NPL still qualifies as anything with 90+ DPD, and the methodological change did not have a significant immediate effect on the total NPL ratio as quarterly NPL ratios were as follows: 20.4% in Q1 2014, 19.2% in Q2 2014, 15.3% in Q3 2014 and 13.9% in Q4 2014.

Despite the substantial losses in the banking sector, CAR improved in 2014 to 17.6%, due to capital contributions by parent banks and a fall in the volume of regulatory prudential filters. Profitability of the banking sector also declined due to write-offs and NPL disposals. ROE and ROA turned from slightly positive in 2013 to deeply negative in 2014. ROE fell by 13.2 points to minus 12.5%, whilst ROA fell by 1.3 points to minus 1.2%. ROA is the second-lowest among the nine countries, behind Hungary (minus 1.6%); and ROE is also the second-lowest, behind Hungary.

Table 16. Key metrics in Romania

Macro	2013	2014	Change (% point)
GDP (% real change pa)	3.5%	2.8%	-0.7%
Consumer prices (% change pa)	4.0%	1.1%	-2.9%
Recorded unemployment (%)	7.3%	6.8%	-0.5%
Budget balance (% of GDP)	-2.5%	-1.9%	0.6%
Public debt (% of GDP)	36.8%	39.8%	3.0%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (RON mn)	103,540	102,117	-1.4%
Corporate loans (RON mn)	113,483	105,468	-7.1%
NPL volumes			
Retail NPLs (RON mn)	14,150	n/a	n/a
Corporate NPLs (RON mn)	33,033	n/a	n/a
NPL ratios			
Retail NPL ratio (%)	13.7%	n/a	n/a
Corporate NPL ratio (%)	29.1%	n/a	n/a
Key ratios			
CAR (%)	15.0%	17.6%	2.6%
ROE (%)	0.8%	-12.5%	-13.2%
ROA (%)	0.1%	-1.2%	-1.3%
CIR (%)	55.7%	54.9%	-0.7%
L/D (%)	82.5%	86.1%	3.6%
FX share of lending (%)	61.0%	57.0%	-4.0%

In view of the accelerated disposal of distressed assests from portfolios in 2014, the corporate and retail NPL data have not yet been disclosed by NBR
Source: EIU, NBR, ECB CBD

CIR decreased slightly by 0.7 points to 54.9%. The L/D ratio at 86.1% is below the regional average (96.4%) and indicates a self-financing banking sector. Driven by the factors mentioned previously, the FX share of lending decreased by four percentage points in 2014; however FX lending is 57.0% (similar to Bulgaria) and is the second-highest ratio among the nine countries.

Table 17. Top players in the Romanian banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	BCR	13,169	8,871	1,140	-528	-4.0%	-46.3%	23.0%	2,038	Erste Group
2	BRD	10,078	6,899	1,225	10	0.1%	0.8%	20.3%	1,400	Société Générale
3	Banca Transilvania	7,945	4,466	829	100	1.3%	12.1%	10.9%	485	Private
4	Raiffeisen	6,410	4,313	743	114	1.8%	15.3%	10.7%	460	Raiffeisen
5	Unicredit Tiriac	6,402	4,200	652	18	0.3%	2.8%	9.6%	403	UniCredit
6	CEC Bank	6,243	3,009	474	2	0.0%	0.4%	21.7%	654	State
7	ING	4,180	n/a	FB	n/a	n/a	n/a	n/a	n/a	ING
8	Alpha Bank	3,782	2,927	400	-58	-1.5%	-14.6%	15.3%	448	Alpha Bank
9	Volksbank	2,757	1,931	159	-424	-15.4%	-266.7%	9.3%	180	Banca Transilvania
10	Bancpost	2,573	n/a	269	n/a	n/a	n/a	16.3%*	n/a	Eurobank Ergasias
	Banking sector total	**82,347**	**46,307**	**7,847**	**-977**	**-1.2%**	**-12.5%**	**13.9%**	**6,451**	

*Q1 2015 data
Source: Banks' data disclosure, NBR, ECB CBD, ISI Emerging Markets
FB: foreign branch

As mentioned previously, measures taken by the central bank significantly affected the profitability and the asset quality of the Romanian banking sector. Only two of the top ten banks, Volksbank and UniCredit Tiriac, have a NPL ratio below 10.0%. The NPL ratios of Banca Transilvania and Raiffeisen are slightly in excess of 10.0%. The market leader BCR has the highest NPL ratio, 23.0%, but BRD and CEC Bank also have NPL ratios above 20%. Both BCR (from 30.6% to 23.0%) and BDR (from 24.8% to 20.3%) substantially reduced their NPL ratios between 2013 and 2014, due to siginficant NPL disposals and write-offs. Volksbank also sold a significant NPL portfolio in 2014. Banca Transilvania, UniCredit Tiriac and Raiffeisen were attempting to dispose of their NPLs, but without transparent market procedures. Regarding profitability, only Banca Transilvania and Raiffeisen managed to achieve a moderate ROE, 12.1% and 15.3% respectively. Three of the top ten banks, BCR, Alpha Bank and Volksbank, were heavily loss-making in 2014, due mainly to the immediate effect on profits of NPL disposals and write-offs. Asset concentration of the banking sector is under the average for the nine countries in this study: the top three, five and ten banks have market shares of 38%, 53% and 77% respectively. Corresponding regional averages are 43%, 56% and 77%. Equity concentration is also lower than the regional average: the top three, five and ten banks hold 41%, 59% and 75% of total equity respectively.

The largest bank is BCR with market share of 16% of total assets, followed by BRD and Banca Transilvania, accounting for 12.2% and 9.6% of total banking assets. At the end of 2014, two banks among the top ten had domestic ownership: the state-owned CEC Bank and Banca Transilvania are controlled by Romanian individuals or legal entities, with the EBRD as a minority shareholder.

M&A activity also picked up. The acquisition of Volksbank by Banca Transilvania was successfully closed: Banca Transilvania took control of Volksbank in April 2015 for a transaction price of EUR 81mn. UniCredit Group also agreed to increase its stake in UniCredit Tiriac from 50.6% to 95.6%, by acquiring Ion Tiriac's 45% share for an undisclosed consideration. In addition, US fund J.C. Flowers acquired a stake in Banca Comerciala Carpatica and submitted a binding offer to buy Piraeus Bank in 2015, the merger of which would create a new top ten bank. Smaller players in the Romanian banking market were also active, such as OTP Bank Romania with the acquisition of Banca Millenium for EUR 39mn.

Debt sales market in Romania

Table 18. Romanian consumer debt market

PLN bn	Portfolios offered for sale*	Average prices
2014	2.2	11%
2013	2.6	10%

*Face value
Source: Kruk

Although the supply of non-performing consumer loans contracted in 2014, from PLN 2.6bn (about EUR 0.6bn) to PLN 2.2bn (about EUR 0.5bn), sales of non-performing mortgage-backed and corporate portfolios gained momentum. This was propelled by accelerated balance sheet clean-ups in the banking sector, as recommended by the central bank. According to Kruk figures, the volume of mortgage-backed debt offered for sale was PLN 1.8bn in face value (about EUR 0.4 bn), while that of corporate loans amounted to PLN 5.1 bn (about EUR 1.2bn). As for pricing data, average prices for consumer loans (as a percentage of face value) rose slightly by one point to 11.0%; however no data was published by Kruk relating to mortgage and corporate NPL transactions.

Slovenia

Following a decline of 0.9% in 2013, real GDP in Slovenia increased by 2.4% in 2014, mainly on the back of net exports and investments in public infrastructure, utilising EU funds. Despite economic growth, inflation fell by 1.4% points to 0.4%. Backed by the improving economic conditions, the rate of unemployment reached a turning point in 2014: having peaked in 2013 at 13.1%, it fell by 3.5 points in 2014 to 9.6%, which is well below the 11.8% average for the nine countries in this study. The budget deficit grew further to 4.9%. Public debt increased substantially in 2014, rising by a woeful 24.2 percentge points, driven by essential recapitalisations of stricken state-owned banks. Capital injections provided by the state helped banks to sustain capital adequacy and restore confidence in the banking system.

Both retail loan volumes and NPL volumes decreased by 1.7%. The retail NPL ratio remained unchanged at 5.3%, which is the third-lowest among the nine countries, behind Slovakia and the Czech Republic. The reason for these low NPL ratios is that Slovenia has a much higher rate of home ownership than other countries in the region as a result of the government`s home ownership policy in the early 1990s. Consequently there is less demand for home loans and we therefore see fewer retail NPLs.

The most acute NPL problem in Slovenia relates to corporate lending. A state-owned bad bank, Bank Asset Management Company (BAMC), was established in 2013 to take on soured corporate loans. Corporate NPL transfers began in 2013 and continued in 2014 (involving NLB, NKBM, Abanka and Banka Celje among the top ten banks), resulting in huge declines in corporate loans and NPL volumes. Nevertheless in 2014 the Slovenian banking sector still had about EUR 2bn of corporate NPLs on banks` balance sheets and a corporate NPL ratio of 17.7%. Therefore the corporate NPL problem has not yet been resolved.

In addition to NPL transfers to BAMC, open market deals are also to be expected, fuelled by the increasing propensity of banks to sell, together with strong investor interest.

Table 19. Key metrics in Slovenia

Macro	2013	2014	Change (% point)
GDP (% real change pa)	-0.9%	2.4%	3.3%
Consumer prices (% change pa)	1.8%	0.4%	-1.4%
Recorded unemployment (%)	13.1%	9.6%	-3.5%
Budget balance (% of GDP)	-4.4%	-4.9%	-0.5%
Public debt (% of GDP)	56.7%	80.9%	24.2%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (EUR mn)	8,918	8,762	-1.7%
Corporate loans (EUR mn)	14,191	11,191	-21.1% ▬
NPL volumes			
Retail NPLs (EUR mn)	473	464	-1.7%
Corporate NPLs (EUR mn)	2,895	1,981	-31.6% ▬
NPL ratios			
Retail NPL ratio (%)	5.3%	5.3%	0.0%
Corporate NPL ratio (%)	20.4%	17.7%	-2.7% ▬
Key ratios			
CAR (%)	11.8%	15.8%	4.0%
ROE (%)	-96.8%	-2.7%	94.1%
ROA (%)	-8.3%	-0.3%	8.0%
CIR (%)	66.1%	58.2%	-7.8%
L/D (%)	96.4%	107.0%	10.5%
FX share of lending (%)	0.0%	0.0%	0.0%

▬ Significant write-downs and corporate NPL transfers to BAMC took place in 2014.

Source: EIU, BSI, ECB CBD

Given the previously-mentioned capital injections, CAR improved by four percentage points points in 2014, to 15.8%. After losses in 2013 triggered by the AQR in 2013, resulting in poor profitability ratios, ROE and ROA both show a considerable improvement in 2014, achieving minus 2.7% and minus 0.3% respectively. CIR also declined substantially to 58.2% in 2014 from 66.1% in 2013. The L/D ratio rose above 100% in 2014. The FX share of lending is not an issue, as the euro is the national currency.

Table 20. Top players in the Slovene banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol	Major owner
1	NLB	8,886	5,686	1,205	82	0.9%	6.8%	21.2%	1,205	State
2	NKBM	3,608	2,070	580	36	1.0%	6.2%	22.4%	464	State
3	SID Banka	3,577	3,045	355	5	0.1%	1.4%	13.4%	409	State
4	Abanka Vipa	2,602	1,213	295	-195	-7.5%	-66.1%	13.1%	159	Zavarovalnica Triglav
5	UniCredit Banka	2,579	1,937	244	1	0.0%	0.4%	17.5%	340	UniCredit
6	SKB Banka	2,550	1,976	337	35	1.4%	10.4%	5.6%	110	Société Générale
7	Banka Koper	2,289	1,739	280	7	0.3%	2.5%	10.6%	184	Intesa Sanpaolo
8	Sberbank Banka	1,779	1,339	147	6	0.3%	4.1%	14.2%	191	Sberbank
9	Banka Celje	1,712	1,046	202	-21	-1.2%	-10.4%	21.8%	228	State
10	Gorenjska Banka	1,441	993	187	2	0.1%	1.1%	22.8%	226	Sava
	Banking sector total	**41,437**	**19,953**	**4,364**	**-117**	**-0.3%**	**-2.7%**	**12.3%**	**2,445**	

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

Only SKB Banka of the top ten banks has a NPL ratio below 10.0%. Three out of the top four state-owned banks have NPL ratios above 20.0%, indicating poor portfolio quality. Abanka Vipa and Banka Celje transferred a substantial amount of corporate NPLs to BAMC in 2014, resulting in lower NPL ratios. The volume of transferred non-performing claims amounted to EUR 1 billion in the case of Abanka Vipa and EUR 0.4 billion from Banka Celje. In 2013, the NPL ratios of Abanka Vipa and Banka Celje were 44.2% and 31.2% respectively. The majority of NPL transfers from NLB and NKBM had already taken place in 2013. It should be noted that Abanka Vipa implemented a new internal definition of NPLs which makes it difficult to compare 2014 with historical figures. Foreign-owned top ten banks managed to keep their NPL ratios under 20.0%. Asset concentration among the top three, five and ten banks is under the regional average, with 39%, 51% and 75% respectively. Corresponding regional averages are 42%, 56% and 77%. On the other hand, equity concentration is greater than the regional average, with the top three, five and ten banks accounting for 49%, 61% and 87% of total equity. Domestic ownership is predominant in the Slovene banking sector, as six of the top ten banks are controlled domestically, four owned by the state, and two in the hands of local entities. All the three largest banks are state-owned: NLB has a market share of 21.4% based on assets, followed by NKBM with 8.7% and SID Banka with 8.6%.
The smaller Banka Celje was nationalised in 2014.

In aligment with the Slovene government's privatisation plans, Apollo Global Asset Management (80% stake) and the European Bank for Reconstruction and Development (EBRD) (20% stake) acquired NKBM in June 2015 for EUR 250mn. Other banking privatisations are also expected in the future: Abanka Vipa and Banka Celje are being merged by the state, to be sold off after creating the third largest bank. Privatisation of NLB is also expected.

Croatia

Economic recovery in Croatia is still awaited. Real GDP fell by 0.4% in 2014, due mainly to sluggish domestic demand. However growth in net exports contributed positively to real GDP. As a result of this sluggish economic performance, Croatia moved back into deflation in 2014, amidst weak domestic spending and collapsing global energy prices. Although the average unemployment rate fell by three percentage points in 2014 to 17.3% from 20.3% in 2013, it is still the second-highest figure in the region (behind Serbia). The budget deficit increased further to 5.7% and public debt as a percentage of GDP also increased by 4.3 points to 85.1%.

The contraction of both retail and corporate loan volumes continued in 2014, owing to the still-ongoing deleveraging trend. Retail loan stock decreased slightly by 0.8%, whilst the volume of corporate loans fell much more, by 9.1%.

Retail NPL stocks remained on an upward trend, with a substantial increase of 8.0%. Corporate NPLs decreased slightly, by 0.7%. Both retail and corporate NPL ratios increased in 2014, by 1.0 and 2.6 percentage points respectively. Compared to the other countries in this survey, Croatia has the highest corporate NPL ratio (30.7%) and the third-highest retail NPL ratio (12.1%, behind Hungary and Bulgaria).

CAR is the second-highest amongst the nine countries (behind Bulgaria) at 21.4%. Despite the sluggish economy, profitability of the Croatian banking sector improved moderately in 2014: ROE increased by 2.3 points and ROA by 0.3 points. At the same time, the current ROE of 3.6% is still the second-lowest positive figure among the nine countries, outperforming only Serbia (ROE of 0.6%) and the loss-making Hungarian and Romanian banking sectors. CIR continued to trend upwards, by one percentage point to 53.2%. The L/D ratio fell substantially in 2014 by 17.5% points, to below 100%; therefore the banking sector achieved self-funding. The FX share of lending remained unchanged for the third year in a row at 74.0% which is the highest ratio out of the nine countries. The proportion of CHF-denominated mortgage loans in the Croatian banking sector account for 36% of total mortgage loans. In January 2015, the Croatian government fixed the Swiss Franc exchange rate at 6.39 to mitigate the currency risk stemming from CHF-denominated household loans. The Consumer Credit Act was an answer to Swiss National Bank's step of abandoning the formerly-defended 1.2 EUR/CHF exchange rate. The Croatian government is also considering the conversion of CHF loans to euros.

Table 21. Key metrics in Croatia

Macro	2013	2014	Change (% point)
GDP (% real change pa)	-1.0%	-0.4%	0.6%
Consumer prices (% change pa)	2.2%	-0.2%	-2.4%
Recorded unemployment (%)	20.3%	17.3%	-3.0%
Budget balance (% of GDP)	-5.4%	-5.7%	-0.3%
Public debt (% of GDP)	80.8%	85.1%	4.3%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (HRK mn)	127,426	126,454	-0.8%
Corporate loans (HRK mn)	108,224	98,402	-9.1%
NPL volumes			
Retail NPLs (HRK mn)	14,173	15,301	8.0%
Corporate NPLs (HRK mn)	30,431	30,209	-0.7%
NPL ratios			
Retail NPL ratio (%)	11.1%	12.1%	1.0%
Corporate NPL ratio (%)	28.1%	30.7%	2.6%
Key ratios			
CAR (%)	20.9%	21.4%	0.5%
ROE (%)	1.3%	3.6%	2.3%
ROA (%)	0.2%	0.5%	0.3%
CIR (%)	52.2%	53.2%	1.0%
L/D (%)	116.2%	98.7%	-17.5%
FX share of lending (%)	74.0%	74.0%	0.0%

Source: EIU, HNB, ECB CBD

Table 22. Top players in the Croatian banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	Zagrebacka Banka	13,377	7,611	1,951	193	1.4%	9.9%	19.6%	1,488	UniCredit
2	Privredna Banka Zagreb	9,021	5,161	1,412	107	1.2%	7.6%	13.4%	690	Intesa Sanpaolo
3	Erste	7,856	4,440	1,019	35	0.4%	3.4%	20.7%	920	Erste
4	Raiffeisenbank Austria	4,102	3,200	620	48	1.2%	7.7%	14.8%	473	Raiffeisen
5	Hypo Alpe-Adria-Bank	3,755	2,486	420	33	0.9%	7.9%	11.8%	293	Société Générale
6	Splitska Banka	3,688	2,331	720	-17	-0.5%	-2.4%	0.0%	0	HAA
7	Hrvatska Postanska Banka	2,268	1,620	84	-83	-3.7%	-98.8%	26.0%	421	State
8	Otp Banka Hrvatska	2,072	1,482	214	2	0.1%	0.9%	13.3%	197	OTP
9	Sberbank	1,340	n/a	175	5	0.4%	2.9%	n/a	n/a	Sberbank
10	Kreditna Banka	557	253	35	-5	-0.9%	-14.3%	6.5%	16	Croatian citizens
	Banking sector total	**56,513**	**29,362**	**7,898**	**284**	**0.5%**	**3.6%**	**16.7%**	**5,943**	

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

The unfavourable trends in the Croatian economy are a burden to the banking sector, which has the third-highest total NPL ratio among the nine countries in the study (behind Serbia and Hungary), and also relatively low profitability. Only one bank out of the top ten banks, Kreditna Banka, has a NPL ratio below 10%. Two of the top three banks have NPL ratios greater than 15%, and the seventh-largest bank, Hrvatska Postanska Banka, has a very high NPL ratio of 26.0%. Three banks out of the top ten reported losses in 2014, and the overall profitability of the banking sector was relatively low as none of the top ten banks achieved a ROE above 10.0%. The highest ROE of 9.9% was achieved by the market leader, Zagrebacka Banka. Although profitability measures inched higher in 2014, the consequences of the already-mentioned measures by the Croatian government are likely to exert a downward pressure on profitability in future. Hrvatska Postanska Banka posted a disastrous ROE of minus 98.8%, as loan loss provisions quadrupled in 2014 relative to 2013, and the bank lost practically all its equity in a single year. Asset concentration in Croatia is the second-highest in the region. The top three, five and ten banks' market share account for 54%, 67% and 85% of total banking assets. Corresponding regional averages are 43%, 56% and 77%. The asset-based market share of the largest bank is 23.7%. Equity concentration is the highest among the nine countries for the top three and five banks (with 56% and 69%) and the third-highest among the top ten banks, with their share amounting to 84%.

Eight out of the top ten banks are foreign-owned and only two banks are controlled domestically: Kreditna Banka is entirely owned by Croatian citizens, whilst Hrvatska Postanska Banka is controlled by the state. At the same time, the Croatian government is now seeking investors to provide a capital injection and increase the current low CAR of Hrvatska Postanska Banka, a step towards its planned privatisation. In July 2015, Advent International Corporation and the EBRD took ownership of Hypo Alpe Adria Group.

Although there have already been some initiatives aimed at reducing NPL stocks, there is room for further improvement. The HNB reported individual sales of non-performing portfolios, chiefly limited to non-market deals. In 2014, 70.0% of all distressed asset sales were to affiliated enterprises. It is anticipated that the Croatian government, in tandem with HNB, will speed up the resolution of non-performing loans; this is expected to help ignite the debt sales market.

Bulgaria

Bulgaria's real GDP increased by 1.7% in 2014, driven mainly by domestic demand. This was offset by a significant contraction in net exports. Inflation fell by 2.3 points due to collapsing global energy prices, resulting in deflation of 1.4%. Unemployment remained practically unchanged relative to the previous year, at 11.2%. Both the budget deficit and public debt deteriorated, the budget deficit of 3.7% exceeding the 3% Maastricht criterion. Nevertheless, Bulgaria's public debt is still the lowest amongst the nine countries in this study.

There was a reduction in both retail and corporate loan volumes, by a modest 1.2% and a much more substantial 10.4% respectively. Although both retail and corporate NPL stocks decreased, by 1.5% and 7.0%, the retail NPL ratio levelled out at 13.2%, whilst the corporate NPL ratio increased by 0.7 points. The corporate NPL ratio at 20.0% is the third-highest out of the nine countries, behind Serbia and Croatia. In addition, only Hungary (19.2%) has a higher retail NPL ratio than Bulgaria.

The implementation of the capital requirements regulations and directive (CRR/CRD) had a positive impact on CAR, which increased by five percentage points from an already sound basis to 21.9%. Despite a fall in lending growth, the profitability of the banking sector improved moderately in 2014. ROE rose by 1.8 points to 7.2%, whilst ROA climbed by 0.2 points to 0.9%. CIR improved by 4.7 points to 48.8%, which is the second-lowest ratio in the region. The L/D ratio fell by 1.3 points to 87.3%, reflecting the reliance of the banking sector on deposits from its retail and corporate clients. 57.0% of outstanding loans are denominated in a foreign currency, a fall of four percentage points compared to 2013.

Table 23. Key metrics in Bulgaria

Macro	2013	2014	Change (% point)
GDP (% real change pa)	0.9%	1.7%	0.8%
Consumer prices (% change pa)	0.9%	-1.4%	-2.3%
Recorded unemployment (%)	11.3%	11.2%	-0.1%
Budget balance (% of GDP)	-1.8%	-3.7%	-1.9%
Public debt (% of GDP)	18.6%	27.4%	8.8%
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (EUR mn)	9,252	9,145	-1.2%
Corporate loans (EUR mn)	19,153	17,160	-10.4%
NPL volumes			
Retail NPLs (EUR mn)	1,230	1,211	-1.5%
Corporate NPLs (EUR mn)	3,695	3,438	-7.0%
NPL ratios			
Retail NPL ratio (%)	13.3%	13.2%	-0.1%
Corporate NPL ratio (%)	19.3%	20.0%	0.7%
Key ratios			
CAR (%)	16.9%	21.9%	5.0%
ROE (%)	5.3%	7.2%	1.8%
ROA (%)	0.7%	0.9%	0.2%
CIR (%)	53.5%	48.8%	-4.7%
L/D (%)	88.6%	87.3%	-1.3%
FX share of lending (%)	61.0%	57.0%	-4.0%

Source: EIU, BNB, ECB CBD

Table 24. Top players in the Bulgarian banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	UniCredit Bulbank	7,590	5,544	1,146	124	1.6%	10.8%	14.5%	804	UniCredit
2	DSK Bank	5,102	3,672	799	118	2.3%	14.7%	15.0%	551	OTP
3	First Investment Bank	4,421	3,239	372	16	0.4%	4.2%	17.7%	572	Private
4	United Bulgarian Bank	3,359	2,569	596	39	1.2%	6.5%	32.7%	839	NBG
5	Eurobank Bulgaria Postbank	3,142	2,203	424	6	0.2%	1.4%	19.2%	423	Eurobank Ergasias
6	Raiffeisen	3,058	2,175	465	24	0.8%	5.1%	14.7%	320	Raiffeisen
7	Soc. Gén. Expressbank	2,338	1,693	274	25	1.1%	9.2%	10.6%	179	Société Générale
8	Central Cooperative Bank	2,138	993	186	4	0.2%	2.0%	2.4%*	24	CCB Group
9	Alpha Bank	1,873	652	FB	-1	0.0%	n/a	26.6%	173	Alpha Bank
10	Piraeus	1,662	1,272	306	-16	-1.0%	-5.4%	32.1%	408	Piraeus Bank
	Banking sector total	**43,937**	**26,305**	**5,543**	**396**	**0.9%**	**7.2%**	**14.1%**	**4,649**	

*2013 data
Source: Banks' data disclosure, BNB, ECB CBD, ISI Emerging Markets
FB: foreign branch

Due to the banking sector crisis in June 2014, there was a setback in lending growth in the second half of 2014. The crisis was caused by two banks experiencing a run on deposits. First Investment Bank managed to handle the turbulence and recover, but Corporate Commercial Bank was put under state administration and its licence was revoked, due to suspicious transactions.

Profitability improved slightly and the total NPL ratio for the banking sector came down to 14.1% from 14.5% in 2013. Two banks out of the top ten have NPL ratios greater than 30%, United Bulgarian Bank and Piraeus, with 32.7% and 32.1% respectively. The NPL ratio for Alpha Bank is also very high, at 26.6%. In contrast, Central Cooperative Bank has an exceptionally low NPL ratio of 2.4%. The top three banks managed to keep their NPL ratios under 20.0%, with OTP managing to cut DSK Bank's NPL ratio to 15.0%, from 20.1% in 2013. ROE at 7.2% was the fourth-highest among the nine countries; however it remained unsatisfactory. The two market leading players, UniCredit Bulbank and DSK Bank, achieved a ROE above 10%. Losses were reported by two banks, Alpha Bank and Piraeus. Asset concentration is close to the median level for the top three and five banks, at 39% and 54%. The ten largest banks have assets amounting to 79% of the total banking market, which is above the median level for the nine countries. UniCredit Bulbank has a market share of 17.3% based on banking assets, DSK Bank has 11.6% and the third-largest bank, First Investment Bank holds 10.1%.

Equity concentration is slightly below the regional average: the top three, five and ten banks account for 42%, 60% and 82% of total equity. Only two out of the ten largest banks are in domestic ownership. The major shareholders of First Investment Bank are Tzeko Minev (42.5%) and Ivailo Mutafchiev (42.5%), and Central Cooperative Bank is in the hands of state-owned CCB Group. The presence of Greek banks (NBG, Eurobank, Alpha Bank, Piraeus) is strong in Bulgaria, which (bearing in mind the recent Greek economic and banking crisis) is also an underlying factor behind subdued lending and the protracted crisis in Bulgaria. From a debt sales market perspective, these four Greek-owned banks have by far the highest NPL ratios amongst the top ten banks, and together hold about EUR 1.8bn of NPLs on their books. The NPL sales activity of the Greek owned banks is therefore expected to increase as they seek to reduce their NPL levels.

Serbia

After achieving real GDP growth of 2.5% in 2013, the Serbian economy slid back into recession in 2014, as GDP fell by 1.8%. As a result of the consequences of a flood in May 2014 and also tepid demand from foreign trade partners. Inflation also fell by four percentage points to 3.6%, due mainly to lukewarm domestic demand. However the unemployment rate was not impacted negatively by the economic downturn, as it fell by 4.4 points. Both the budget deficit and public debt increased in 2014, to 6.6% and 71.0% of GDP respectively.

Following retail lending growth of 3.2% in 2013, growth in 2014 was a meagre 0.4%. The volume of corporate loans continued to fall, although at a lower rate than the previous year (when there was a 19.9% reduction), due to the impetus from the government's subsidised corporate lending programme. Even so the volume of outstanding corporate loans fell considerably, by 10.5%.

The corporate sector was affected by high NPL volumes. Being well aware of the acute NPL problem, and also amid mounting pressure from international creditors, the Serbian government has already announced a national NPL Resolution Strategy.
A secondary NPL market is to be built up, to reduce the mountains of NPLs. These measures have provided a tailwind for the debt sales market, and has begun to attract international investors in distressed assets. Progress was already visible in 2014, as corporate NPLs fell by 7.2% due to NPL disposals and write-offs. In contrast, retail NPL volumes inched slightly higher, by 0.4%. The retail NPL ratio remained practically unchanged compared to 2013, at 11.5%. The corporate NPL ratio increased by one percentage point to 29.0%, which is still the second-highest level (behind Croatia) among the nine countries in the study.

CAR increased slightly to a robust 20.4%, the third-highest level among the nine, behind Bulgaria and Croatia. Profitability indicators turned to the positive territory in 2014, with ROE of 0.6% and ROA of 0.1%. CIR fell moderately by 1.2 points, but it is still the second highest figure in the region, behind Hungary. Although the loans/deposits ratio fell in 2014, it is still higher than in any other countries at 110.8%, reflecting the fact that banks also rely on foreign sources of funding. The FX share of lending dwindled slightly by three points; however it is the second-highest level among the nine countries.

Table 25. Key metrics in Serbia

Macro	2013	2014	Change (% point)
GDP (% real change pa)	2.5%	-1.8%	-4.3% 🔴
Consumer prices (% change pa)	7.6%	3.6%	-4.0% 🟢
Recorded unemployment (%)	27.2%	22.8%	-4.4% 🟢
Budget balance (% of GDP)	-4.9%	-6.6%	-1.7% 🔴
Public debt (% of GDP)	61.2%	71.0%	9.8% 🔴
Banking sector	**2013**	**2014**	**Change (% or % point)**
Retail loans (EUR mn)	6,015	6,037	0.4% 🟢
Corporate loans (EUR mn)	9,036	8,085	-10.5% 🔴
NPL volumes			
Retail NPLs (EUR mn)	689	692	0.4% 🔴
Corporate NPLs (EUR mn)	2,527	2,344	-7.2% 🟢
NPL ratios			
Retail NPL ratio (%)	11.5%	11.5%	0.0% ⚫
Corporate NPL ratio (%)	28.0%	29.0%	1.0% 🔴
Key ratios			
CAR (%)	19.9%	20.4%	0.5% 🟢
ROE (%)	-0.4%	0.6%	1.0% 🟢
ROA (%)	-0.1%	0.1%	0.2% 🟢
CIR (%)	65.5%	64.3%	-1.2% 🟢
L/D (%)	116.0%	110.8%	-5.2% 🟢
FX share of lending (%)	72.0%	69.0%	-3.0% 🟢

Source: EIU, NBS, ECB CBD

Table 26. Top players in the Serbian banking sector

#	Bank (2014, EUR mn)	Assets	Loans	Equity	Net Profit	ROA	ROE	NPL ratio	NPL vol.	Major owner
1	Banca Intesa	3,910	2,677	870	56	1.4%	6.4%	12.0%	320	Intesa Sanpaolo
2	Komercijalna Banka	3,359	2,029	575	40	1.2%	7.0%	17.7%	360	State
3	UniCredit Banka	2,193	1,528	457	45	2.1%	9.8%	17.8%	272	UniCredit
4	Raiffeisen Banka	1,853	1,248	462	43	2.3%	9.3%	12.9%	161	Raiffeisen
5	Société Générale Banka	1,838	1,437	280	3	0.2%	1.1%	19.2%	275	Société Générale
6	AIK Banka	1,433	820	439	15	1.0%	3.4%	34.4%	282	MKG
7	EFG Eurobank	1,208	n/a	365	-22	-1.8%	-6.0%	n/a	n/a	Eurobank Ergasias
8	Vojvođanska Banka	1,004	648	163	1	0.1%	0.6%	18.0%	117	NBG
9	HAAB	981	n/a	228	-7	-0.7%	-3.1%	n/a	n/a	HAA
10	Banka Poštanska	937	n/a	144	3	0.3%	2.1%	n/a	n/a	JP PTT Srbija
	Banking sector total	**27,352**	**14,122**	**5,286**	**31**	**0.1%**	**0.6%**	**21.5%**	**3,036**	

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

Although corporate NPL volumes fell substantially in 2014, due to shrinking corporate loan volumes, the total NPL ratio remained virtually unchanged at 21.5%, which is the highest level among all nine countries. In 2013 Romania had the highest NPL ratio with 21.9%, but this was reduced substantially in 2014 to 13.9% via massive NPL disposals and write-offs. However, as the NPL Resolution Strategy carries on delivering positive results in 2015, improved NPL data is expected from Serbia by year-end 2015.

AIK Banka has an alarmingly high NPL ratio of 34.4%, which substantially exceeds the average for the Serbian banking market. The NPL ratio of all the top five banks exceeds 10%, and for the three largest banks in the top ten it even exceeds 15%. NPL ratios of the top ten banks are similar to their 2013 figures, except for Société Générale Bank, whose NPL ratio surged from 9.4% in 2013 to 19.2% in 2014. With regard to profitability, the four largest banks can be separated from the rest of the top ten, as both their ROE and ROA are well above the national average. Only two banks from the top ten recorded losses in 2014, EFG Eurobank and HAAB. Asset concentration is well below the regional average: the top three, five and ten banks account for 35%, 48% and 68% of total banking assets respectively. The market leader, Banca Intesa, has an asset-based market share of 14.3%, followed by Komercijalna Banka with 12.3% and UniCredit Banka with 8.0%.

Equity concentration is the lowest for the top three and five banks: the share of these groups amounted to 36% and 50% of total equity of the sector respectively, and for the top ten banks equity concentration is 75%. The majority of the top ten banks are in foreign ownership, and only three banks, the state-owned Komercijalna Banka, AIK Banka and Banka Poštanska (owned by the Serbian Post) are domestically-owned. It should be noted however that Komercijalna Banka, whose biggest shareholder is the Serbian state (40.8%) followed by the EBRD (23.9%) and International Financial Corporation, is being privatised and completion of this transaction is expected by 2017. In July 2015, Advent International Corporation and EBRD acquired ownership of Hypo Alpe Adria Group. As in Bulgaria, Greek-owned banks have an established presence in Serbia, owning seventh- and eighth-largest players Eurobank and NBG. These two banks have high NPL ratios and volumes, and may generate debt sales market activity as part of the current refurbishment of the Greek banking sector.

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