

Competence Center “Sourcing in the Financial Industry”

BankersCom CEE 2010

Conference Summary
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The financial and economic crises of the past years have transformed into a crisis of the Euro currency and the Euro area. Banks have to find new ways to evade the slow growth in Western Europe. In order to discuss the situation and possible courses of action with respect to doing business in Central- & Eastern Europe, >>BankersCom CEE 2010<< offered a platform for analyses and solutions. Regarding the CEE region, the outlook is heterogeneous but rather promising. Thus >>Challenging Times but Recovery on the Horizon<< was the motto of the conference.

Vienna, June 1st 2010 – The turbulences on the financial markets and their impact on the whole economy have pushed CEE (Central and East European) countries into recession. Local banks have been affected heavily by the financial crisis. A possible retreat of large banks from the CEE area has been discussed. Now, outlooks for some CEE countries are much better than for most other European countries, but the landscape remains heterogeneous. Which strategies will be successful in the long-term and rebuild trust and strength? How will the future look? To focus on questions like these, the executive management conference >>BankersCom CEE 2010<< at Leopold Museum Vienna gathered top-class speakers from banking science and management. Together with more than 100 executives of 15 financial institutions from the CEE, they developed outlooks for the future of the CEE region. Special attention was paid to the requirements and structural approaches to mastering the aftermath of the crisis and to the strategic positioning of banks.

In his welcome statement, **Daniel Braxatoris**, responsible for >>BankersCom CEE 2010<< at uvision GmbH (organizer), pointed out what BankersCom stands for: Firstly for communication, networking and exclusive discussions. Secondly for the community of more than 100 top banking executives from 15 financial institutions in CEE that was attending the conference. Thirdly for commerce and the strong business aspects that are tied to the conference and ensured by its partners, namely Avaloq, CLS Communication, Cognizant, Oracle, Temenos, Comit, Mammut Soft Computing, and Pulinco.

After Daniel Braxatoris, moderator **Philipp Vorndran** (financial market strategist at Flossbach & von Storch and former chief strategist at Credit Suisse Asset Management), took the stage. Taking a global perspective, the mistrust against the Euro was his topic. He said that the Chinese for example, despite aiming at diversifying their currency reserves, had not bought the Euro because they are worried about the PIIGS (Portugal, Ireland, Italy, Greece and Spain) countries. When discussing current developments in Europe with Chinese business partners, CEE countries offer much more chances and have less problems than the PIIGS countries, Mr. Vorndran said. Bank managers had to materialize the potentials. These potentials found a sharp contrast in Western Europe where people lived beyond their means. He summarized, that growth will be limited in Western Europe, will be acceptable in CEE, and probably will be fantastic outside the region, as expected by Mr. Vorndran. Given these expectations: How will banks position be in the future? What will happen to European currencies? These questions were discussed by the following speakers.

As the first speaker, **Prof. Dr. Erich W. Streissler** (economist at the University of Vienna) presented his *Propositions on Global Financial Markets and Future European Financial Developments*:

- According to the basic definitions of national accounting, investments limited savings. For 10 years, the world has been in an excess savings situation. Banks dealt with a surplus of savings but have no real investment opportunities. Thus on a large scale, many savings evaporated in loss-making projects. With eventually unsustainable high asset prices, seemingly high profits were made by banks. After 2007-2008, many banks had a sensation of “looking around and suddenly discovering to be a lemming”, running after financial investments in ultimately loss making fields.
- Though on a global scale, savings have to equal investments, savings and investments do not have to be equal for single countries or regions. Net savers were East Asian countries like China and Japan, the major oil exporting countries, and, in Europe, Switzerland, Germany, Austria, the Netherlands, Denmark, and Sweden. On the other hand, the USA has had savings deficits since 1981, which since 2001 have increased to two thirds of excess word savings. Therefore, the USA was the biggest sink for money around the world, destroying it largely in form of consumption instead of investments that create returns.
- There is no difference between the USA and Greece, because both had about the same ratio of government budget deficit per gross domestic product (GDP). The USA with -11% actually even has the larger deficit than Greece with 9.4%. But the difference is huge in the perception at financial markets. While Greece is seen as a disaster, the USA is seen as a marvelous opportunity for financial investment.
- Government finance was largely financed by banks because to them it seemed to be a safe harbor. Banks which invested in “safe” government finance now witnessed that government finance might be just as risky as “speculative” private finance. Some banks were cautious and avoided over-expansion, as e.g. French banks in general, and Credit Suisse in Switzerland.
- The biggest domestically owned Austrian banks, Erste Österreichische Bank and Raiffeisen Bank have swerved off to finance profitably South Eastern Europe. Building up development finance there, they were unjustly talked down by some German banks, which had been late-comers in Eastern Europe: Rumors spread by Germany forced Austria to increase its savings rate by 1 per cent over German rates.
- Real Estate, e.g. in Romania in contrast to the USA, had only been given credit up to 40-50 percent of value, the credit being in terms of Euros, which increased due to devaluation the actual debt load. Industrial finance has been riskier in these countries. And some countries were much more risky than others: Ukraine (aggregate income drop by 20% in 2009); and, in the North, the Baltic states.

The next speaker went on with the topic of reasonably investing in CEE. **Dr. Helmut Breit** (executive vice president, Corporate, Trade & Export Finance Division at RZB) gave an inside view on: *The Future of CEE Banking: Bright Prospects?!* While in February 2009 international news coverage about CEE was severe, one year later the public had turned its eyes on other states, according to Dr. Breit. Even so risk was still there, the situation for CEE was improving. In 2009, the economic contraction had been fuelled by quite a number of factors like soaring risk premiums, dried-up cross border funding and interbank lending, collapsed exports following a decline in global trade, stopped foreign direct investment, high current account deficits plus economic downturn that led to

sharply depreciating local currencies, labor costs that soared in CEE countries, and home-made problems in countries like Ukraine, Hungary, and the Baltics. Yet, the current situation looked much brighter for the following reasons:

- CEE countries generally avoided systemic banking failures
- Many currencies rebounded due to low public debt levels in CEE
- Credit default spread (CDS) levels decreased and are reaching pre-crisis levels for CEE
- Stock markets strongly increased and liquidity is back
- CEE is expected to show a GDP growth of around 3 % on average for 2010 and thus to outperform most European countries
- Loan demand was (and continues to be) weak
- CEE markets have outperformed Western markets over the last 6 months
- CEE countries are less indebted than Greece and Italy and also absolute amounts are much smaller

However the economic situation in CEE was still as fragile as in the rest of Europe, the Euro crisis also affected the CEE region, and austerity measures in Greece, Spain, Portugal, and Great Britain were expected to impact the whole of Europe with a marked decline in consumer spending. Altogether, the medium term outlook for CEE and the banking industry of Dr. Helmut Breit showed the following characteristics:

- Industrial production and GDP will increase
- Growth rate differential compared to the rest of Europe is around + 2 %
- Loan loss provisions of banks in CEE will further decline, making operations more profitable
- Risk return ratios will be favorable compared to contracting North Mediterranean countries
- This will improve allocation of capital resources (equity and debt) for CEE region

In *How the CEE Banking Landscape has Changed in the Short Term – The Quiet After the Storm or Just the Eye of the Hurricane?*, **Carlo Marini** (executive vice president and head of CEE corporate and investment banking at UniCredit Group) added arguments to Mr. Breit's aspects on banking in CEE. Although significant differences existed between single countries, Mr. Marini expected CEE to outperform the rest of Europe and to be an attractive area for banks. For instance, his outlook for Russia was very ambiguous: On the one hand Russia was a powerful and strong nation. On the other hand it was especially exposed to currency fluctuations, oil price and other factors. In contrast, Turkey was one of the most resilient countries, came out of the crisis early, and shows good growth and prospects. Given these diverging perspectives, the current challenge for UniCredit was to understand where to put how much money in the next years. Industry was expected as the first segment to gain momentum, whereas the retail sector was more problematic due to high rates of unemployment.

CEE was positioned well below Western European countries in terms of debt so that the Greek crisis impacted CEE only to some extent but especially through the presence of Greek banks in CEE. Since risks were relatively lower in CEE than in Western Europe, appreciations of investments in CEE were like a return to reality of properly pricing risks. Also the banking system was in a better shape than before the crisis, making CEE a key pillar for UniCredit Group strategy, especially if Western Europe should not be picking up. With respect to exchange rates, this led to the expectation that the Euro converged down to CEE currencies while CEE currencies lifted up.

Turning his eyes on *World Economy: Crisis Over?*, **Prof. Norbert Walter** (managing partner of Walter & Töchter Consult and former chief economist of Deutsche Bank) contributed thoughts on the following topics. First of all, he made clear that to him any answer to the title of his speech appeared premature. Then Prof. Walter questioned if, facing immense country differences, there has ever been a world economy at all. In Asia, growth rates were that high, that one could even fear overvaluations. Moreover, Asia's sustainability should be questioned. Travelling to Singapore or Shanghai, he met people who were absolutely convinced that they were kings of the world whereas Westerners were weaklings. Systems that nowadays excelled were the state-organized, non-democratic ones. Citizens' rights were not being considered as important for welfare according to the perception of the "new world", issues which for Prof. Walter were a root problem and reminded him of the importance of Japanese banks in 1990. Japanese banks had been by far the strongest capitalized institutions in the world. The inner city of Tokyo had had the same property value as the whole of California. His only conclusion was: "What a nonsense! Market prices are wonderful sometimes, but occasionally they are just rubbish."

What about us, the Western part of the world? Europe, according to Prof. Walter, had been weak even before the Greek tragedy and is rather considered like a shopping basket by international investors than as a uniform area and especially the CEE area was very heterogeneous. Differentiation was necessary. This fragmentation however, was not too bad since financial markets were to be seen in conjunction with the real economy. From the depreciation of the Euro against many other currencies, the manufacturing sectors of Austria and Germany were expected to profit enormously. Could it be that the Greek crisis is an invention by German and Austrian manufacturers?

The current corrections were necessary but had the downside of less impressive growth rates on an aggregate level. In summary, the downturn in Western Europe was expected to be dramatic, but emerging markets outside the region were only little affected. This was advantageous for the Western Countries due to import implications.

On a timescale to Prof. Norbert Walter,

- 2009 was a year of recession,
- 2010 is a year under drugs, but by now almost everybody understands that this is not sustainable and that the public sector is overleveraged. Therefore, in
- 2011 donor countries will exit financing.

To alleviate the situation, exports could be a solution for Western economies. Emerging countries require, for instance, Western know-how in energy efficiency, organizing urban areas / urban development / livable cities, and the development of a tourism industry.

Being vice-governor of the Austrian national bank, **Dr. Wolfgang Duchtacek** provided insights on *Austria and CESEE 2010* (CESEE - Central Europe and South East Europe) and on what is driving the work of European national and central banks these days. Plainly, this was to preserve the stability of the Euro. However, the main issue of handling the crisis was getting more and more difficult.

The massive loss of confidence in CESEE had triggered multilateral support in the form of money supply to the markets and the "Vienna Initiative" had helped to rationalize measures. Nevertheless, economic downturn had been inevitable and caused significant loan losses and reduced banks' profitability. To respond, changes in regulation and supervision were required, e.g. to strengthen the resilience of the banking sector through

Basel III / CRD IV and to Europeanize financial supervision through the creation of the ESRB (European Systemic Risk Board).

The Austrian banking sector showed heterogeneous developments. Net interest income has been supported by a historically steep yield curve and cheap central bank liquidity. Moreover, remarkable re-appreciations of securities and trading profits have taken place in 2009 after losses in the fourth quarter of 2008. Therefore, the aggregate Austrian banking sector has remained profitable but dispersion widened. The crisis revealed the non-sustainability of business models and improper risk management of some banks. Due to unemployment and bankruptcies in Austria, significant credit risk remained.

Despite activities in CESEE supported profitability, uncertainty remained also in CESEE: Reduction of policy support and a trade-off between the discussion of sustainable standards and regulatory uncertainty formed the major challenges. Risks existed due to political uncertainty, unfolding of hidden risks (e.g. restructuring), possible changes in investor sentiment, and the debt crisis in advanced economies.

Focusing on a bank in the Polish market, **Jaroslav Myjak**, vice president of corporate business at PKO Bank Polski (PKO), lectured on the *Financial Crisis and its Impact on a Leading Bank's Strategy*. According to him, Poland has suffered from an interbank crisis (not subprime, etc.). The local market has been strong enough (40 million population), Polish consumers have spent a lot, and Poland's cheaper currency has helped with exports. The problem had been rather that the Polish banking sector was in foreign hands by 70%, which were reluctant to open new credit lines and thus shrinking themselves and the economy. Despite this, Poland needed less monetary or fiscal stimuli and thus did not lose trust. In terms of CDS quotations, Poland was punished as a part of a volatile region. At least, Polish CDS quotations were significantly lower than those of the PIIGS states.

His own employer, PKO, was a conservative savings bank and the largest bank in the country. The challenges of 2009 were rather modest for PKO, as the reluctance of other banks became a chance for PKO because PKO did not stop its loan activity. As a crisis is a time in which attitudes dominate, being local, PKO had an information advantage which helped it to make faster decisions. Nowadays, PKO was especially engaging in high prime mortgages and SME banking, making it the only bank in Poland that has growth in assets. Nevertheless, spreads go up for PKO as well due to the Greek effect and might hit hard.

With an impulse speech, **Michael Hysek**, managing director for banking supervision at the Austrian Financial Market Authority (FMA) opened the panel. The panel was captioned *Current Status of Banking Business in Austria & CEE-Region: What has Changed? Impact and Policy Implications from the Crisis to the Players of the Austrian- & CEE-Financial Centers*. According to him, the impact was that risk positions went up while net incomes went down. This led to policy implications regarding regulation and supervision: In the regulatory field, stronger shock absorbers through better risk capture (e.g. stronger liquidity standards) and prevention measures (e.g. debt-equity-standards) were needed. To complement this, a stronger supervision was necessary, for example through a reinforced dialogue between banking industry and supervision and through the consolidation of EU supervisors.

László Wolf, Deputy CEO, Commercial Banking Division at OTP Bank, stressed that CEE was a good place for banks because the macroeconomic situation has improved significantly and growth was expected to be at 3% after 2011. Therefore, the European crisis hardly was applicable to CEE.

Prof. Dr. Martin Janssen of the Swiss Banking Institute at Zurich University dealt with the question 'How to advise clients to reallocate assets? Although it was hard to look into the future, what investors have seen is that investments in G7 or G20 states were no longer safe havens. Therefore, a well diversified portfolio of corporate bonds might outperform.

Dr. Helmut Breit explained that the question is not if Russia will be back one day but, since Russia was already back, how it will invest its reserves of USD 500 bn

In a final dialogue, **Prof. Dr. Erich Streissler** and **Philipp Vorndran** summarized the conclusions of the day and shared a positive short and medium term growth outlook for CEE. The common theme of most speakers was to look for alternative investment opportunities in a low margin world. Mr. Vorndran therefore pushed this topic and asked Prof. Dr. Streissler for prudent investment opportunities for both bankers and investors. Answering this from a long term perspective, Prof. Dr. Streissler looked at both the financial side and the real side. On the financial side, he saw two constellations. In the US they were that huge deficits being made, that Prof. Dr. Streissler expected a strong depreciation of the dollar after a certain period of time. This pushed exports of the USA. Therefore, the export situation was better than the financial situation. In Europe it was quite different: Cutting away budget deficits of countries rather rapidly, led to a re-depression, resulting in extra appreciation of the Euro. This led to a good internal situation but hurt exports and had not stimulated growth. From the real side, people witnessed a much slower growth rate. Euro countries therefore should invest in Eastern Europe to generate profits there.

Thanking all guests on behalf of the partners and associate partners of BankersCom, **Daniel Braxatoris** made the closing remark: "BankersCom CEE will be back in 2011 and we are looking forward to seeing you again."

uvision: uvision develops and leads independent and sustainable executive management communities from vertical sectors and their partners providing added value. The design and implementation of marketing and network events are the core aspects of its achievements. Long-term executive management experience, wide subject expertise and know-how are the key factors leading to these achievements. The key markets of uvision are the financial services industry and on the information & communication technology sector. uvision was founded in January 2006 and is based on a strategic cooperation with Kunz & Partner Management Consultants.

Competence Center Sourcing in the Financial Industry (CC Sourcing): CC Sourcing at the universities of St. Gallen, Leipzig und Zurich researches the transformation to the "Bank 2015" with 18 partner companies. Besides the management of transformations, this encompasses future scenarios for specialization in the banking industry, models of electronic customer interfaces, standards as a prerequisite for electronic networking of financial service providers, as well as the development of functional service architectures to integrate business processes and application systems. Its fourth project phase will begin in July 2010 and have the guiding theme "Customer and Service Oriented Design of Networked Banks".

More information is available at www.uvision.ch, www.bankerscom.ch, and www.ccsourcing.org.