Recent developments

The Austrian economy grew strongly in the first half of 2022. This growth spurt is mainly attributable to catching-up effects on both the demand side, i.e. in private consumption and foreign trade, and the supply side, namely in industry, wholesale and retail trade, and food services. However, in the second half of 2022 this brisk growth pace will level off markedly. A spurt in inflation since the beginning of the year and high uncertainty related to the war in Ukraine will weigh on the recovery. Strong inflation keeps slowing income growth and, by extension, consumption. Monetary policy tightening, which goes hand in hand with rising interest rates for the wider economy, drives up financing costs. This, in turn, puts a damper on companies' willingness to invest. Still, due to Austria's good economic performance in the first half of 2022, economic growth will come to slightly below 5% for 2022 as a whole, compared to 4.7% in 2021.

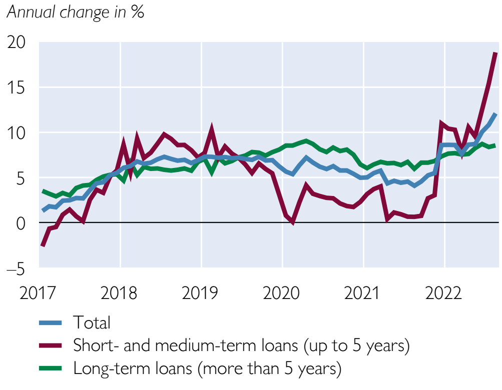
Companies: insolvencies still below pre-pandemic levels

Austrian companies have been borrowing more since the last quarter of 2021. The growth rate of bank loans to companies started to accelerate in September 2021 and amounted to 12.1% (year on year) in August 2022 (see chart 1). This marked increase over the last couple of months has been attributable to a strong demand for short- and medium-term loans (i.e. loans with maturities up to five years). The Austrian results of the euro area bank lending survey (BLS) point to companies' high financing needs for inventories and working capital (rather than for capital investment). According to the banks surveyed, companies in Austria have built up their stocks to secure future deliveries as the war in the Ukraine had aggravated supply chain disruptions. Apart from that, the recently high loan demand also reflects anticipatory effects of rising future interest rates. Expecting imminent monetary policy tightening, companies are likely to have taken out loans now in order to profit from favorable interest conditions.

Austrian companies' stronger borrowing in the first half of 2022 took place amid favorable economic developments. Loan growth has been accelerating particularly strongly in the industries, which had been hit hard by the COVID-19 pandemic and have been recovering steadily – most notably the manufacturing and trade industry (wholesale and retail). On the back of strong loan growth, overall debt in the corporate sector (i.e. loans and bonds) increased by EUR 6.5 billion in the first half of 2022. However, given the strong rebound of the Austrian economy, the debt-to-GDP ratio has been on a downward path since it peaked in Q1 21 (declining from 79.8% to 75.1% in Q2 22). In contrast, the aggregate corporate sector's debt-to-income ratio[1] went up in the first half of 2022 as companies' profits went down in the same period.

Chart 1

Bank loans to Austrian companies

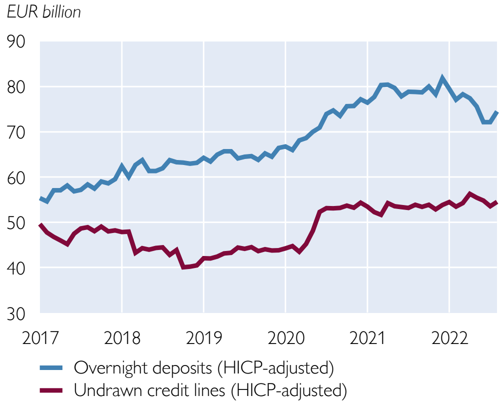


Source: OeNB.

[1] *Defined as the consolidated gross debt of the corporate sector as a share of gross operating surplus.*

Chart 2

Indicators of Austrian companies' liquidity



Source: OeNB.

Standing at 324.8% in Q2 22, the ratio still remains below the peak of 333.1% it had reached early in the pandemic in Q2 20 and well below the euro area average of 354.9%. Rising energy prices and interest rates as well as further possible supply chain disruptions could put a drag on companies' profits and thus negatively affect debt sustainability. It is likely that such developments will not fall evenly across businesses and could make highly indebted firms particularly vulnerable to adverse shocks.

The buildup of liquidity buffers that accelerated during the COVID-19 pandemic has come to a halt. Compared with the end of 2021, companies' overnight deposits held by Austrian banks declined markedly (see chart 2). There is evidence that government support measures taken during the COVID-19 pandemic might have driven up firm deposits significantly.[2] Hence, the reduction by almost 9% observed in the last eight months could reflect the gradual expiry of these measures. Despite the recent drop in overnight deposits, liquidity buffers (at EUR 74.5 billion) are still above the pre-pandemic level of end-2019 (EUR 66.5 billion). Moreover, companies have access to additional liquidity if needed, as they have a substantial amount of undrawn credit lines at their disposal (EUR 54.5 billion in August 2022). These credit lines increased strongly at the beginning of the COVID-19 pandemic and have remained rather constant since (see chart 2).

Companies' debt-servicing costs remained low in the first half of 2022 but are expected to increase amid rising interest rates. The ratio of interest payment obligations for domestic bank loans to gross operating surplus amounted to 2.9% in Q2 22. This ratio corresponds to the historically low figures observed over the last five years and reflects the still low level of interest rates. As the bulk of new (euro-denominated) loans consists of variable rate loans (81% in Q2 22), interest expenses are expected to rise soon in the wake of monetary policy tightening. Hence, a considerable share of companies' outstanding loan volumes is exposed to interest rate risk. Moreover, the borrowing costs of new debt will go up, irrespective of whether interest rates are agreed to be fixed or to be allowed to float. Given that short-term loans (with maturity periods of up to one year) make up only a small share (15%) of companies' outstanding loan volumes, the related refinancing risks are rather moderate.

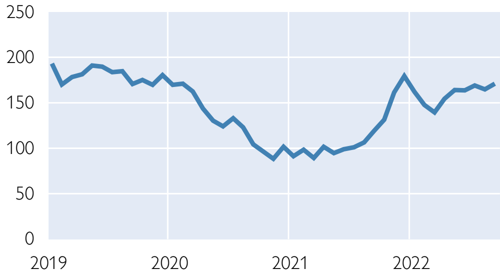
[2] *See Elsinger et al. 2022. Where have all the insolvencies gone? In: Monetary Policy & the Economy Q3/22. OeNB. Forthcoming.*

Insolvency numbers[3] have started to rise since mid-2021 after having fallen significantly in the first year of the pandemic. The reduction observed early in the pandemic reflects neither underlying economic developments nor higher rates of firm exits (due to other reasons), but is mainly attributable to government support programs aimed to mitigate adverse developments in the corporate sector.[4] Despite the increase recorded since mid-2021 (see chart 3), the number of insolvencies remains below pre-pandemic levels (according to the latest available data of September 2022). However, as mitigating measures continue to expire, insolvencies might rise further in the near future, especially as input prices and interest rates go up.

Chart 3

Insolvencies

Number of insolvencies, three-month moving average

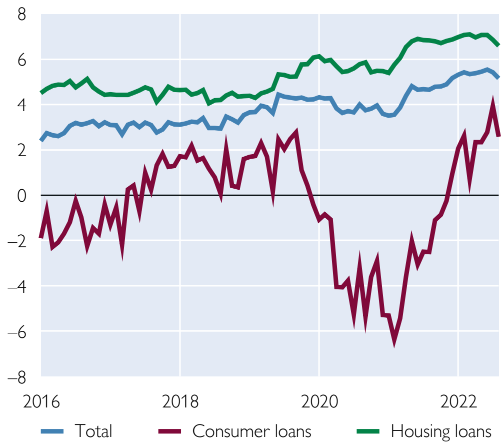


Source: Austrian insolvency register, authors' calculations.

Chart 4

Bank loans to households

Annual change in %



Source: OeNB.

Households: sufficient debt-servicing capacity despite rising prices and interest rates

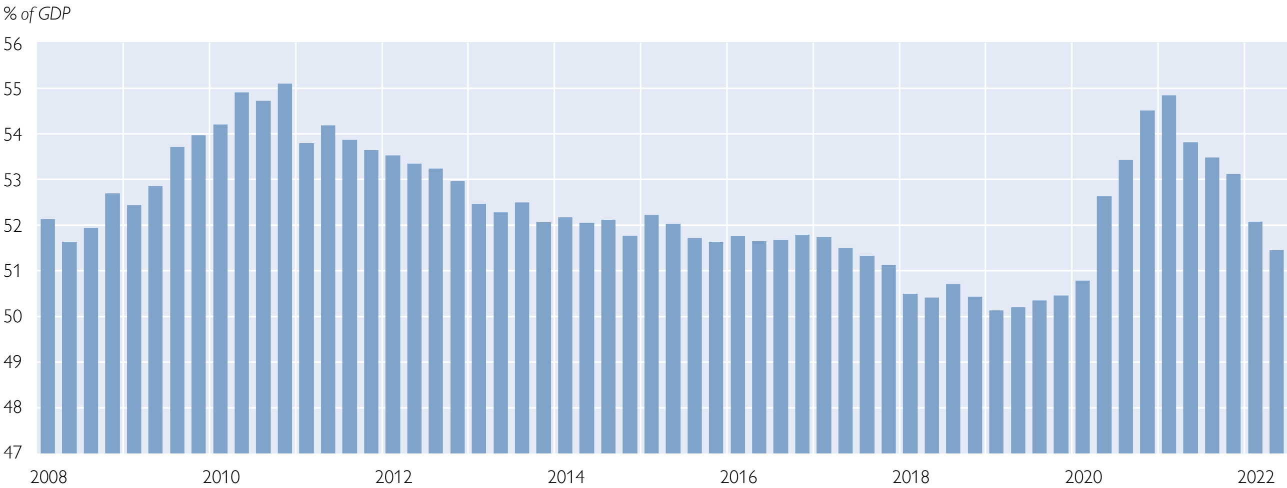
Austrian banks' lending to households has grown at a rather constant pace since end-2021, standing at 5.2% in August 2022. While consumption loans have rebounded, dynamics in lending for housing purposes have been rather stable (chart 4). Accounting for a share of about 70%, housing loans make up a large portion of overall outstanding bank loans and are therefore significant in shaping total lending growth in Austria. In August 2022, housing loans grew by 6.6%, thus remaining at a relatively high level. BLS results indicate first signs of a possible trend reversal. While Austrian banks again slightly tightened their credit standards for housing loans in the second quarter of 2022 (compared to Q1 22), they said they expected credit standards to tighten further, and more significantly, in the third quarter and demand for housing loans to decline from the high levels observed in recent years.

[3] *Insolvency numbers reflect insolvencies of firms that are registered in the Austrian business register without sole proprietorships, i.e. excluding the household sector. Please note that these figures are not based on the same database as the figures presented in previous Financial Stability Reports, where sole proprietorships were included. As the bulk of loan volumes is held by firms in the nonfinancial corporate sector, the figures presented here better reflect the risks to financial stability. For a detailed definition, see Elsinger et al. 2021. The calm before the storm? Insolvencies during the COVID-19 pandemic. In: Financial Stability Report 41. OeNB. 57–76.*

[4] *See Elsinger et al. 2022. Where have all the insolvencies gone? In: Monetary Policy & the Economy Q3/22. OeNB. Forthcoming.*

Chart 5

Household debt



Source: OeNB, Eurostat.

Rising economic activity and nominal disposable household income cushion relatively strong lending growth. The level of total household sector debt in relation to GDP has been decreasing since the peak it had reached during the pandemic in Q1 21, amounting to 51.5% in Q2 22 (see chart 5). This figure is below the average value observed over the last 15 years (52.4%). Likewise, total debt as a share of net disposable income has been on a downward path since Q1 21. At 94.0% in Q2 22, it is slightly above the average observed since 2008 (91.5%). Hence, aggregate debt statistics so far do not point to any steady debt accumulation in the household sector.

Residential property prices in Austria grew more slowly in Q3 22. From the beginning of 2021, housing prices grew at rates of above 10% year on year, peaking in the second quarter of 2022 at 13.1%. In Q3 22, the growth rate of residential property prices dropped to 10.8%. This slowdown is largely attributable to price developments in Vienna, where house price growth decelerated from 13.0% to 9.6% in the third quarter of 2022.

Rising inflation dampens real disposable household income in 2022. On the back of high employment and wage growth, the growth of households' disposable income is anticipated to more than double in 2022, in nominal terms, from figures recorded in the previous year. However, inflation continued to rise sharply in Austria in recent months, reaching 10.9% in September 2022, and it is expected to remain high throughout the rest of the year. According to the OeNB's most recent forecast, inflation will amount to 8.5% for 2022 as a whole. This will considerably weigh on real disposable household income, which is expected to stagnate, on average, in 2022.[5] Yet, the impact of inflation on the financial situation

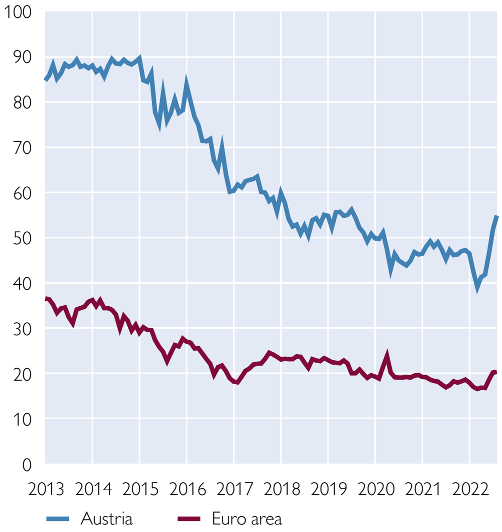
[5] *Fiscal measures to support household income helped prevent real disposable household income from declining steeply in 2022. For further details, see Prammer, D. and L. Reiss. 2022. Fighting (the effects of) inflation: government measures in Austria and the EU. In: Monetary Policy & the Economy Q4/22–Q1/23. OeNB. Forthcoming.*

of individual households is very heterogenous.[6] Indebted households whose financial margins had already been tight before the strong surge in prices might increasingly run into repayment difficulties. Compared to the euro area average, though, the share of indebted households whose expenditures exceed their net disposable income is rather low in Austria (4.6% versus 23.0% in the euro area).[7] Moreover, in general, inflation reduces the real value of debt. Hence, once higher wages compensate borrowers for rising prices, loan repayments become relatively smaller in real terms, which makes it easier to pay off outstanding debt.

Chart 6

Variable rate loans to households

% of total new euro-denominated loans to households



Source: OeNB, ECB.

On top of rising prices, interest rate hikes reduce the financial scope of households that hold variable rate loans. Over the last five years, the average share of variable rate loans in total new euro-denominated loans amounted to 50% in Austria, which is relatively high compared to the euro area average of around 20%. Hence, a considerable share of indebted households faces higher debt service payments amid rising interest rates. While the share of variable rate loans in total new euro-denominated loans decreased considerably since 2015, this trend came to a halt more recently (see chart 6). Past low interest rates made fixed-rate loans more and more popular in Austria, as households took advantage of favorable financing conditions. Over the course of 2022, however, rising policy rates started to make fixed-rate loans more expensive. As a result, Austrian borrowers increasingly turned back to variable rate loans.

An OeNB simulation exercise shows that interest rate and price rises are likely to drive up the number of financially vulnerable indebted households in Austria. This increase is more pronounced when considering rising prices than in a scenario where households only have to face rising interest rates. On the other hand, the associated surge in debt at risk, which reflects the debt held by vulnerable households as a share of overall outstanding debt in Austria, is less pronounced in the scenario of rising prices. This is because households that become vulnerable due to higher inflation mostly hold consumer loans (rather than mortgage loans), whose outstanding debt amounts are relatively low. In contrast, a rise in interest rates mostly affects households holding mortgage loans.

We expect credit risks to remain contained despite the anticipated increase in the number of vulnerable households amid rising prices

[6] *See Fessler P., F. Fritzer and M. Salish. 2022. Who pays the price when prices rise? In: Monetary Policy & the Economy Q4/22–Q1/23. OeNB. Forthcoming.*

[7] *See Albacete et al. 2022. Effects of interest rate and inflation shocks on household vulnerability in Austria: a microsimulation using HFCS data. OeNB. Financial Stability Report 44.*

and interest rates. Simulations from a combined scenario – a rise in prices by 10% and an increase in interest rates by 3 percentage points – reveal that debt at risk would grow from 3.1% to 5.1% of overall outstanding debt in Austria and from 12.0% to 15.8% of overall outstanding debt in the euro area.[8] Hence, both the level of and the increase in debt at risk are significantly lower in Austria than the euro area average. An analysis of further scenarios and more details on the simulation exercise are provided in this issue of the Financial Stability Report by Albacete et al (2022).

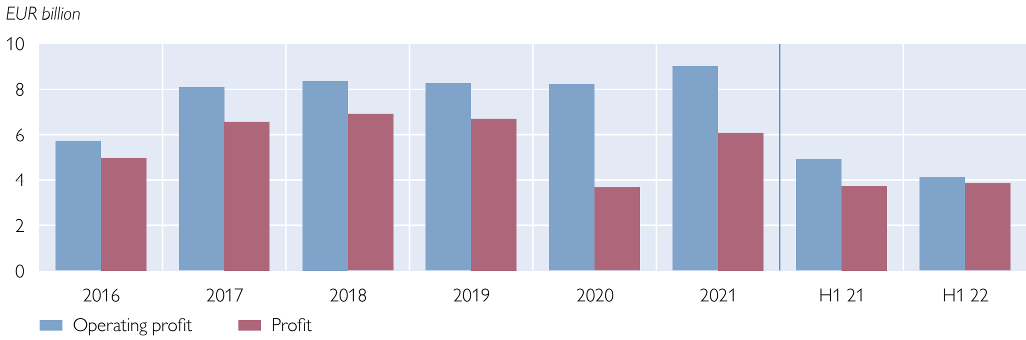
Austrian banking sector: solid foundations serve as firewall against potential future challenges

The Austrian banking sector earned EUR 3.8 billion in the first half of 2022, in line with last year's result. Operating income went up by more than one-tenth year on year to EUR 14.3 billion, supported by stronger net interest income and dynamic growth in fees and commissions, but operating costs rose at a much quicker pace, mainly due to impairments on equity participations. Consequently, operating profit declined (see chart 7). Despite a rise in risk provisioning, several one-off effects – such as extraordinary profits and profits from discontinued operations – resulted in banking sector profits of EUR 3.8 billion for the first two quarters of 2022. As total assets continued to grow, the Austrian banking sector's return on assets declined slightly to 0.6% (–10 basis points year on year).[9]

The profitability outlook for the banking sector is fairly uncertain, given rising interest rates, stronger inflation and elevated geopolitical uncertainties. On the one hand, given their large stock of variable rate loans, Austrian banks' net interest margin could profit from the end of the low interest rate environment. On the other hand, higher loan – and potentially deposit – rates, strong inflation and the fact that customers are affected by the surge in production costs and cost of living may drive up (funding, operating and risk) costs and slow down lending. The development of credit quality also depends on the extent of public support measures, which reduce the financial strain on households and

Chart 7

Profitability indicators of the Austrian banking system



Source: OeNB.

[8] *In this scenario, we assume only loans with adjustable interest rates to be affected.*

[9] *For an in-depth analysis of Austrian banks' profitability from 2017 to 2021, please refer to the special topics section in this Financial Stability Report (Gruber, M. and S. Kavan. 2022. DuPont reloaded: the profitability of the Austrian banking sector and the impact of the COVID-19 pandemic).*

corporations in light of energy price hikes. In these highly uncertain times, the Austrian banking sector benefits from the strong resilience it built up over the last decade. Going forward, banks should aim at protecting this resilience by being very careful with regard to profit distributions and ensuring that credit and interest rate risk management practices adequately reflect changes in the risk environment.

The Austrian banking sector's total assets rose strongly in the first half of 2022, while credit quality remained unchanged. Austrian banks' consolidated total assets surpassed EUR 1.2 trillion, as lending was brisk (see above). These dynamics contributed to stabilizing banks' nonperforming loan (NPL) ratio at the historically low level of 1.8% in June 2022. Well over half of banks' NPLs are classified as unlikely to pay, yet not overdue, and an additional 1.8% of loans were forborne. At the same time, the coverage of NPLs with provisions declined slightly to 46% as provisioning did not keep pace with the contained (absolute) increase in NPLs.

Thanks to major improvements in capitalization over the past decade, Austrian banks managed both the COVID-19 pandemic and first-round effects of the war in Ukraine well. During the pandemic, Austrian banks benefited from a capitalization level that had more than doubled since the great financial crisis. This helped maintain confidence in the banking sector and positively influenced its assessment by rating agencies and investors. This resilience also supported Austrian financial stability in 2022, after Russia started its war of aggression against Ukraine. During the first half of 2022, however, dynamic lending and the resumption of profit distributions slightly burdened the Austrian banking sector's common equity tier 1 (CET1) ratio, which declined slightly to 15.8%. The Austrian Financial Market Stability Board concluded in its September meeting that Austrian banks' capital levels had remained below those of their European peers and therefore advised that macroprudential buffer requirements be set at an additional 0.5 percentage points for selected banks, to be gradually raised over two years.

Austrian banks' subsidiaries in CESEE recorded a profit of more than EUR 2 billion in the first half of 2022 despite the war in Ukraine and a massive energy price shock. The operating profit surged by 60% year on year to EUR 3.1 billion, supported by expanding operating income (+35%) and a slower rise in operating costs (+13%). Despite a historic low of just 1.8% in the overall NPL ratio (as of mid-2022), credit risk provisioning nearly quadrupled to EUR 0.5 billion. The resulting aggregate profit of more than EUR 2 billion in the first half of 2022 is already higher than in the entire pandemic-burdened year of 2020 and significantly higher than in the first half of 2021. This positive development is also reflected in the return on assets, which rose from 1.2% in the first half of 2021 to 1.4% one year later. Given the clouded outlook for CESEE, including uncertainties related to the war in Ukraine, the supply of natural gas during the winter and monetary policy tightening in several countries, credit risks may rise and Austrian banks are well advised to ensure an adequate level of loan loss provisions.

By mid-2022, the aggregate CET1 ratio of Austrian banks' CESEE subsidiaries stood at 16% and the loan-to-deposit ratio at 70%. These solid levels bear testament to past efforts by banks and supervisors to make local banking systems more resilient. Together with adequate provisions, they will serve financial stability well, as CESEE faces multiple economic and geopolitical challenges going into 2023.

Recommendations by the OeNB

The Austrian banking sector has weathered recent headwinds well so far. During the COVID-19 pandemic and after the onset of the war in Ukraine, the sector benefited from its much-improved capitalization level, solid profitability and a very low NPL ratio. That said, it should be noted that in the first half of 2022, the sector's capital ratio decreased slightly despite high profits, and there is little room left for improving credit quality. The OeNB therefore recommends that banks take the following measures to strengthen financial stability in Austria:[10]

- Strengthen the capital base in a sustainable and forward-looking manner, especially by exercising restraint with regard to profit distributions.
- Adhere to sustainable lending standards for residential[11] and commercial real estate financing.
- Ensure that credit and interest rate risk management practices adequately reflect changes in the risk environment, especially considering the past long period of low risks.
- Continue efforts to improve cost efficiency in order to ensure sustainable profits.
- Further develop and implement strategies to deal with the challenges of new information technologies, cyber risks and climate change.

Box 1

Macroprudential policy in Austria

Macroprudential policy in Austria aims at building up and ensuring high resilience to systemic shocks in the financial system. *Along with this goal come safeguarding public finance and perpetuating frictionless financial intermediation even in times of crisis. To this end, the OeNB follows an integrated approach that relies on the interplay of measures such as macroprudential buffers, borrower-based instruments, resolution and deposit guarantee schemes.*

The Austrian banking system faces a number of key structural systemic risks. *These risks stem from (1) the large, tightly connected financial industry (compared to Austria's relatively small economy) and (2) its low structural profitability, (3) close ties to the real economy and specific ownership structures, (4) insufficient preparation for the discontinuation of implicit state guarantees (long-term structural spread risk) and (5) high exposure, particularly to emerging markets in CESEE.*

To address these structural risks, the Austrian Financial Market Stability Board (FMSB), which is responsible for macroprudential policies in Austria, introduced a systemic risk buffer (SyRB) already in 2016. *Together with the buffer for other systemically important institutions (O-SII buffer), the SyRB considerably contributed to enhancing the Austrian banking sector's resilience, helped maintain its excellent rating, kept refinancing costs at low levels both for the real economy and financial institutions and prevented the banking sector from requiring government support.*

The FMSB regularly reviews its macroprudential policy decisions with a view to financial and macroeconomic developments in Austria and abroad. *In its latest review of its macroprudential buffer policy of September 2022, the FMSB concluded that the above-mentioned structural risks persisted and Austrian banks' capital levels remained below*

[10] *Please note that the European Systemic Risk Board (ESRB) issued a warning on risks to EU financial stability: https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning220929_on_vulnerabilities_union_financial_system~6ae5572939.en.pdf.*

[11] *See box 1 on macroprudential policy in Austria and please also refer to https://www.fma.gv.at/en/fma-issues-regulation-for-sustainable-lending-standards-for-residential-real-estate-financing-kim-v.*

those of their European peers.[12] Therefore, combined SyRB and O-SII buffers continue to fulfill an important role in safeguarding financial stability in Austria.

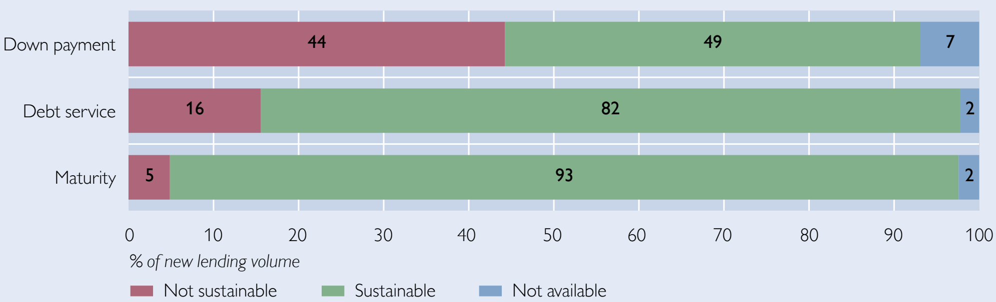
Even if pandemic-related uncertainties have decreased significantly since the FMSB's decision on combined macroprudential buffers in 2020, new uncertainties have arisen, mainly due to Russia's invasion of Ukraine, rising energy prices and high inflation. *Thus, in line with the OeNB's assessment of the impact of the macroprudential buffers on banks and the real economy, the increase of the combined buffer rate will be limited to 25 basis points per year with an overall limit of +50 basis points for the 12 banks subject to SyRB and O-SII buffers for the next two years.[13] The systemic risk analysis that will take place during the next regular evaluation of the macroprudential buffer regime will again consider reactions from banks and the financial system as well as changes in financial and macroeconomic conditions. Based on previous experience in Austria and other EU countries, the OeNB does not expect the FMSB's buffer decisions to significantly affect credit supply in Austria.*

Borrower-based measures address elevated systemic risk from residential real estate financing. *Over the past ten years, residential real estate (RRE) prices have doubled in Austria; in Q2 22, the overvaluation of RRE prices reached a record value of 39%. RRE overvaluation in Vienna is currently estimated at 45%. Rising RRE prices made housing less affordable and the market more vulnerable to credit-driven exuberance and future price corrections.*

Lending to households for house purchase was still growing strongly, at a rate of 7%, in mid-2022. *While the share of variable rate RRE lending in total lending declined in the past, some evidence for the second half of 2022 suggests that it is back on the rise. Variable rate contracts make borrowers vulnerable to rising interest rates. Furthermore, a considerable share of new mortgage loans continues to be offered at unsustainable lending standards: In the first half of 2022, loans with debt service-to-income ratios exceeding 40% accounted for a share of 16% in new lending, leaving little room for maneuver in case of unforeseen adverse developments (e.g. increased costs of living or unemployment) or in the event of interest rate increases. At the same time, 44% of the total loan volume were accounted for by loans for which borrowers' own contribution to project financing was less than 20%. On the positive side, Austria has a well-developed housing rental market with a high share of nonprofit providers, and Austrian borrowers tend to have high incomes and wealth by international standards.*

Chart B1

Sustainability of residential real estate lending in the first half of 2022



Source: OeNB.

[12] *For more details on the FMSB's macroprudential policy decisions of September 12, 2022, see https://www.fmsg.at/en/publications/press-releases/2022/33rd-meeting.html.*

[13] *For more details on the FMSB's policy decisions, see its "Recommendation FMSB/5/2022 on adjusting the systemic risk buffer (SyRB) and the other systemically important institution (O-SII) buffer" at https://www.fmsg.at/en/publications/warnings-and-recommendations/2022/recommendation-fmsb-5-2022.html.*

__However, in times of crisis, systemic risks in RRE financing may prove critical to Austria's financial stability and should therefore be addressed.__ Consequently, and upon the initiative of the OeNB and the FMSB, Austria's Financial Market Authority issued a new regulation including upper limits for loan-to-value ratios (90%), debt service-to-income ratios (40%) and loan maturities (35 years) – subject to exemptions that would give credit institutions adequate operational flexibility. As of August 1, 2022, these new measures apply to all new mortgage lending to households of above EUR 50,000. Furthermore, the FMSB recommended to adhere to a conservative DSTI ratio (30% to 40%) for variable rate loans or loans with a short interest rate fixation period. Borrower-based instruments are internationally accepted as being effective in reducing risks to financial stability and protecting borrowers from taking on excessive household debt.

Box 2

The OeNB's latest solvency stress test for Austrian banks

Background

__The OeNB conducts annual stress tests for all Austrian banks under its dual mandate for banking supervision and financial stability.__ The solvency stress test is designed to assess banks' resilience to adverse macroeconomic shocks and provides insights on both a bank and a system-wide level. Conducted in a top-down fashion, it relies on the OeNB's well-established stress testing framework ARNIE, which is continuously improved. Stress testing covers both significant and less significant institutions at the highest consolidated level. It focuses on risks relevant for the Austrian banking sector, including spillover effects among banks, which are particularly important for the decentralized sector. The most recent stress test is based on data as of end-2021 and covers the period from 2022 to 2024.

Scenarios for the 2022 exercise

__The OeNB's most recent stress test was based on the Eurosystem's June 2022 macroeconomic forecast, with its central projection serving as the baseline scenario and an aggravated version of its downside scenario serving as the adverse scenario.__ The baseline scenario foresees a cumulative GDP growth of 7.9% for the Austrian economy over the stress test horizon (2022–24). In the adverse scenario, the intense phase of the war in Ukraine is assumed to extend into 2023 and subside in 2024, when economic conditions are assumed to return to normal. Russian energy exports are assumed to cease for two years, leading to a rationing of gas supplies, significantly higher commodity prices, lower trade activities and intensified global value chain problems. Austria's GDP would sharply contract in the first two years of the stress test horizon and slightly rebound in the third year, resulting in an overall cumulative growth rate of –4.3%. The euro area and the CESEE countries would experience a GDP decline of around 5%, while Russian GDP would shrink by almost one-quarter over that period. With respect to inflation, large commodity price increases imply intense upward price pressures, resulting in strongly elevated inflation throughout 2022 and 2023; under these assumptions, inflation would return to target levels in 2024. For purposes of this stress test only, both short- and long-term interest rates are assumed to rise above 3%. Real estate prices are projected to drop by 22.3% for both commercial and residential real estate.

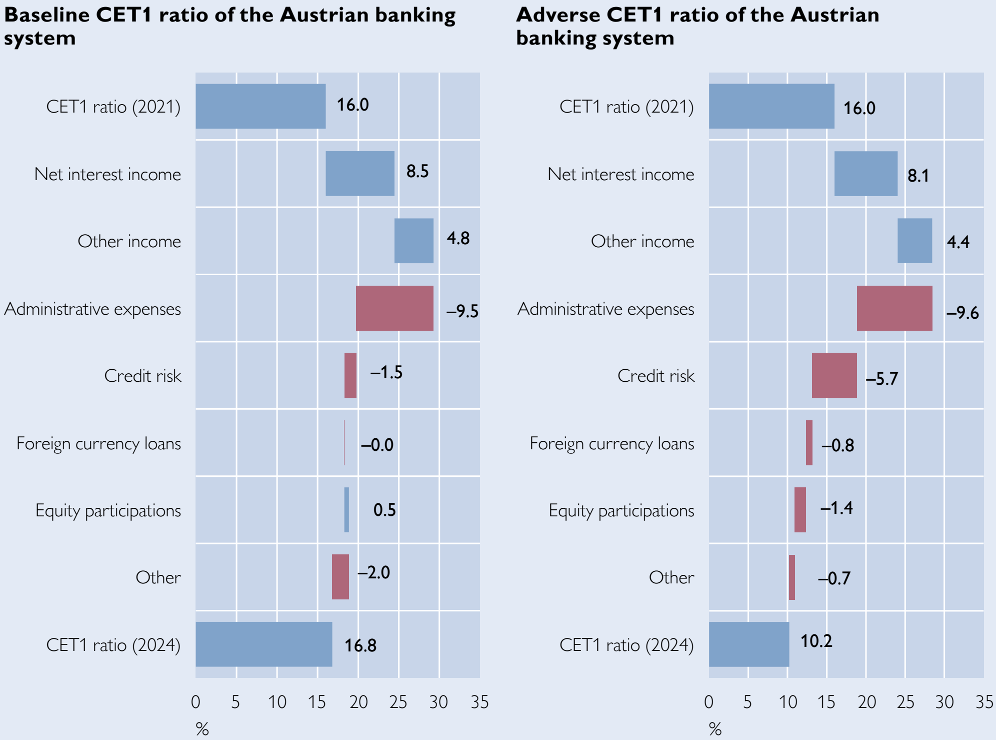
Results and risk drivers

__While Austrian banks' aggregate CET1 ratio increases by 0.8 percentage points in the baseline scenario, it declines by 5.8 percentage points in the adverse scenario, coming to 10.2% at end-2024.__ The waterfall chart shows the most important risk drivers and their contribution to capital depletion for both the baseline and adverse scenarios.

Credit risk remains the main risk driver, drawing down capital by 5.7 percentage points in the adverse scenario (baseline scenario: 1.5 percentage points). Gains and losses from equity

Chart B2

The OeNB's 2022 solvency stress test for Austria – results and risk drivers



Source: OeNB.

participations in nonfinancial corporations and especially in other banks are significant as well. While in the baseline scenario, banks participate in the profits of entities they invested in and build up capital (+0.5 percentage points), the picture reverses in the adverse scenario (–1.4 percentage points) owing to reduced dividend income and the revaluation of equity stakes. In addition, net interest income shrinks from 8.5 percentage points in the baseline scenario to 8.1 percentage points in the adverse scenario, mainly as a result of both higher funding costs and a reduced income generation capacity following increases in nonperforming exposures. An interactive presentation of the results is available on the OeNB's website.[14]

Conclusions

Overall, the stress test results indicate that the Austrian banking system is well equipped to withstand substantial macroeconomic shocks, including energy supply shocks. *The current baseline scenario is less optimistic than that of the 2021 stress test, reflecting the current state of the global economy. The harsher adverse scenario results in more pronounced capital depletion. Higher credit risk losses are, however, partially cushioned by improved net interest income resulting from higher interest rates. Across the Austrian banking system, results are more heterogeneous, with banks that are exposed to more affected regions experiencing greater losses and the equity participation risk channel being more significant in the decentralized sector. Nonetheless, capital ratios remain above those observed before the great financial crisis in 2007/08. The stress test highlights how important it is for the banking sector to be well capitalized. Amidst rising uncertainties and in an increasingly adverse economic environment, Austrian banks should be very careful with regard to profit distributions.*

[14] *https://oenb.shinyapps.io/OeNBStressTests/.*

Box 3

First lessons from the resolution of Sberbank Europe AG

Sberbank Europe AG, a 100% subsidiary of the state-owned Russian bank Sberbank of Russia, had been active as a universal bank headquartered in Austria. *It operated subsidiaries in Bosnia and Herzegovina, Croatia, Czechia, Hungary, Serbia and Slovenia and one branch in Germany that was in charge of collecting direct deposits and performing consumer lending activities. The total assets of this consolidated banking group amounted to EUR 13.6 billion as of end-2021.*

The banking group experienced severe liquidity problems in February 2022. *These problems were attributable to massive liquidity outflows in some countries, following Russia's invasion of Ukraine and related political tensions. Sberbank Europe AG and its subsidiaries in Croatia and Slovenia were assessed as "failing or likely to fail" by the ECB on February 27, 2022. This decision was confirmed by the Single Resolution Board (SRB), which consequently applied a moratorium (suspension of payments, enforcement and termination rights) to the Austrian, Croatian and Slovenian entities. Subsequently, the SRB found that resolution actions for the Croatian and Slovenian subsidiaries were in the public interest, while there was no public interest in the resolution of the Austrian parent entity.*

Following the negative public interest assessment for Sberbank Europe AG's Austrian entity, the Austrian Financial Market Authority (FMA) appointed a government commissioner on March 1, 2022, and banned Sberbank Europe AG from continuing business operations with immediate effect. *The prohibition of business operations legally triggered a deposit guarantee pay-out event in Austria, with Austria's deposit guarantee scheme paying out all covered deposits in the amount of EUR 941 million. Subsequently, following intense efforts of the responsible authorities and the bank itself, the insolvency of Sberbank Europe AG could be averted and the bank's orderly solvent wind-down was started in May 2022. Several asset portfolios were successfully sold to other banks in May and the weeks that followed. This approach ultimately made it possible to retain as much of the bank's asset values as possible. In the course of this wind-down and as a direct result of the executed transactions, Austria's deposit guarantee scheme was reimbursed in full within a short time, meaning that no financial damage occurred to the Austrian banking sector through the failure of Sberbank Europe AG. Also, all other creditors were (or will be) satisfied on time according to the wind-down plan and subject to the sanction regime applying to Russia and Russian legal entities.*

The orderly wind-down of Sberbank Europe AG is currently on track and is scheduled to be completed by end-2022. *After that, Sberbank Europe AG will hand back its banking license. As for Sberbank Europe AG's subsidiaries in CESEE, the subsidiaries in Croatia, Slovenia, Bosnia and Herzegovina, and Serbia were sold and regular business was resumed, while the subsidiaries in Czechia and Hungary are currently being liquidated under the oversight of the competent national supervisory authorities.*

The swift and effective reaction and close cooperation of European and national supervisory and bank resolution authorities ensured the orderly and loss-minimizing market exit of Sberbank Europe AG and its subsidiaries without causing any shock to financial stability. *Still, the authorities did learn some lessons during this challenging resolution process. Sberbank Europe AG with its seven subsidiaries in CESEE has probably been the most complex case of bank resolution in the European Union so far, involving two SSM subsidiaries, two EU non-SSM subsidiaries and three subsidiaries in third countries. Sberbank Europe AG's subsidiaries were subject to different supervision and resolution regimes, which required a swift and comprehensive exchange of information and close alignment between the competent authorities. Harmonizing these regimes would significantly reduce the complexity of such resolution cases.*

Sberbank Europe AG's crisis resulted in a potentially high burden on national deposit guarantee schemes. *The impact on the Austrian deposit guarantee scheme, in particular, was disproportionately high, given the large number of covered deposits in the*

German branch of Sberbank Europe AG, whose operations relied on the freedom of establishment principle.[15] The complexity arising from the multitude of involved deposit guarantee schemes in different countries as well as the burden cross-border deposits placed on these schemes highlight the need to intensify discussions on creating a pan-European deposit guarantee scheme.

Moreover, given the bank's complex cross-border structure, the case of Sberbank Europe AG was particularly challenging also in terms of banking resolution. *The SRB is directly responsible for resolving significant institutions and cross-border banking groups in the euro area only. The resolution of banks and banking subsidiaries outside the euro area is carried out by the national authorities and is outside the SRB's competence. Hence, involving the national authorities responsible for all subsidiaries of cross-border banking groups is key to performing their efficient and loss-minimizing resolution.*

[15] *Credit institutions with a banking license in a member state of the European Economic Area are generally authorized to also provide banking operations in other member states due to the freedom of establishment and the freedom to provide services principles. The intention to provide cross-border banking services must be notified to the competent supervisory authority ("European passporting"). In Austria, the subsequent authorization to provide cross-border banking services in other member states arises following a notification procedure by the FMA.*