Austrian financial intermediaries: banks' profits remained high, but low interest rates challenged the life insurance sector in 2019

Austrian banks performed well in 2019

Consolidation in the banking sector continued

The Austrian banking sector increased in size in 2019, while the number of banks continued to decline. The consolidated total assets of the Austrian banking sector jumped over the EUR 1,000 billion mark in 2019 for the first time since 2016. At the same time, the number of banks dropped further to 573. This corresponds to a reduction of 24 head offices over the last twelve months. The number of bank branches in Austria declined to 3,521, down 3% compared to the previous year. Since 2008, the reduction in the number of banks (minus one-third) and the number of branches (minus one-fifth) has been significant. While the consolidation continued in the domestic market, Austrian banks further expanded their network of foreign branches, especially in Germany, where nearly half of all 229 foreign branches are located.

Foreign claims of Austrian banks continued to climb in 2019, reaching EUR 401 billion at the end of 2019 (on an ultimate-risk basis). This corresponds to an increase of 7% compared to the previous year and 43% of consolidated total assets. The strongest increases in absolute terms were recorded in Spain, Russia, Slovakia and the Czech Republic, while exposure reductions took place for example in Turkey and Liechtenstein.

Low interest rates, increasing competition from online banks and the varying speed of adaptation to new business models are shaping the Austrian banking sector. Cooperative banks increased their market share by 2% over the past few years, while joint stock banks and building societies lost shares in terms of total assets.[1] Online banks also improved their market position.

Austria banks' profits declined slightly in 2019

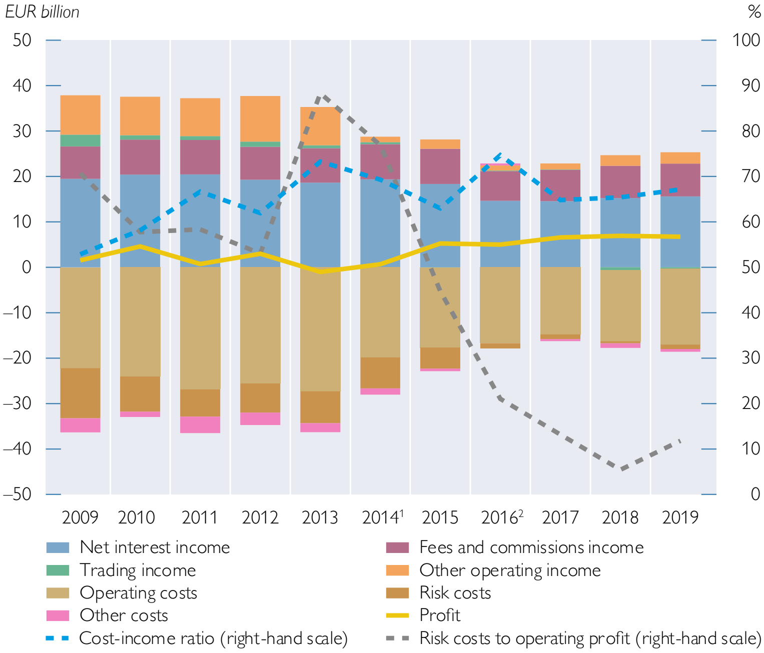
The Austrian banking sector earned a net profit of EUR 6.7 billion in 2019. This translates into a decline of 3% compared to 2018 and a return on average assets (RoA) of 0.7%, which was substantially higher than the average RoA for the EU banking sector (0.4%).

The slight decline in profits can be attributed to rising operating and risk costs, which outweighed increases in the main sources of income. As chart 3.1 shows, net interest income, which makes up more than 60% of total operating income, rose by 2% in 2019, although the net interest margin slightly declined (to 1.5%). Fees and commissions income – accounting for nearly 30% of total operating income – rose by 2%. Given that trading losses were reduced and other operating income rose by 6%, total operating income increased by 4% to EUR 25 billion. However, operating costs grew much quicker: Their 7% rise was caused not so much by an increase in staff and administrative expenses,

[1] *The OeNB monitors seven banking subsectors in its analysis. These reflect the multitier structure of the banking sector, based on different business models, legal forms and ownership structures. Given their similar business models, Raiffeisen and Volksbanken are included in a single cooperative sector.*

Chart 3.1

Consolidated profit and loss statement of the Austrian banking sector



Source: OeNB.

[1] Since 2014, other operating income and other operating costs have been netted.
[2] In 2016, UniCredit Bank Austria's subsidiaries in CESEE were transferred to their Italian parent institution.

which only rose by 1%, but by significant other operating costs, such as the impairment of equity investments and tangible assets. Consequently, the cost-income ratio deteriorated from an already elevated 65% in 2018 to 67% in 2019. Operating profits declined to EUR 8.3 billion (–1% year on year). Since risk costs more than doubled (to EUR 1.0 billion), profits declined by 3% and reached EUR 6.7 billion in 2019.

Low risk costs in a benign macroeconomic environment supported rising profits over the past few years, but this trend seems to have abated. As Austrian banks' cost efficiency remains low and their risk costs appear to have bottomed out, the COVID-19 crisis will be challenging the sustainability of banks' profitability in 2020 and beyond. Much will depend on their ability to lend at risk-adequate margins, while keeping costs under control. Structural issues, which so far have been masked by cyclically low risk costs, will need to be addressed to ensure that banks have enough room for maneuver to continue providing their critical services to the real economy in Austria and their host markets.

Austrian banking subsidiaries in CESEE earned EUR 2.8 billion in 2019, slightly less than in 2018. Their net interest income, which represents the cornerstone of their business model, rose strongly, by 7% year on year, propelled by a rapid expansion of loans to nonbanks (+10% year on year) and a stable net interest margin (2.7%). Since fees and commissions income also increased by 7%, operating income also rose by 7% in 2019. Operating profits, however, were up by only 5%, as operating costs climbed by 8%. This increase was driven by higher staff costs, but in particular by impairments that rose by half (general administrative expenses were flat). As provisioning more than doubled to nearly EUR 0.5 billion,[2] profits declined by 3% to EUR 2.8 billion.

All major Austrian banking host markets in CESEE were profitable in 2019. The Czech Republic has been the most significant profit hub for Austrian banking subsidiaries since the beginning of this decade (except for 2013) and in 2019 contributed one-third to Austrian banking subsidiaries' total profits in CESEE. Austrian banks' subsidiaries in the Czech Republic and Russia together

[2] This includes provisioning of EUR 153 million for losses expected from a decision of the Romanian High Court in relation to the business activities of a Romanian building society subsidiary (see Erste Group's Annual Report 2019 for further details).

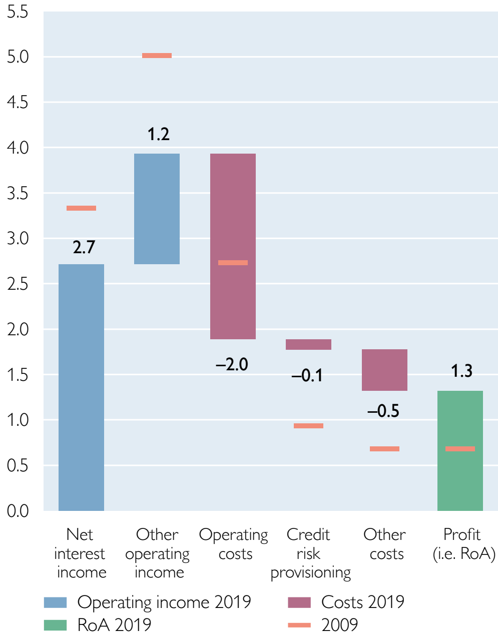
accounted for half of all profits earned in CESEE that year. Also in the Czech Republic, profits increased markedly (+17% year on year), whereas Romania saw a sharp drop in profits (–66%, see also footnote 9).

Over the past decade, the deterioration in operating profitability in CESEE was masked by a very benign economic environment. As chart 3.2 illustrates, the net interest margin of Austrian banking subsidiaries declined from 3.3% in 2009 to 2.7% in 2019. When taking other income into account, the operating income margin fell from 5.0% to 3.9%. Since the changes in the impact of operating costs and other costs on the RoA cancel each other out, the near doubling in Austrian banking subsidiaries' RoA from 0.7% in 2009 to 1.3% in 2019 was due to a substantial reduction in credit risk provisioning. While these risk costs equaled 1.8% of average total assets in 2009, they only had a marginal impact on profitability in 2019 (–0.1%). As the benign period of extremely low risk costs is likely to have come to an end with the COVID-19 crisis, banks' profitability in CESEE is likely to face substantial downward pressures.

Chart 3.2

Austrian banks' subsidiaries in CESEE: return on assets (RoA) and its components (2009 versus 2019)

% of average total assets



Source: OeNB.

Loan growth was high and loan quality improved in 2019

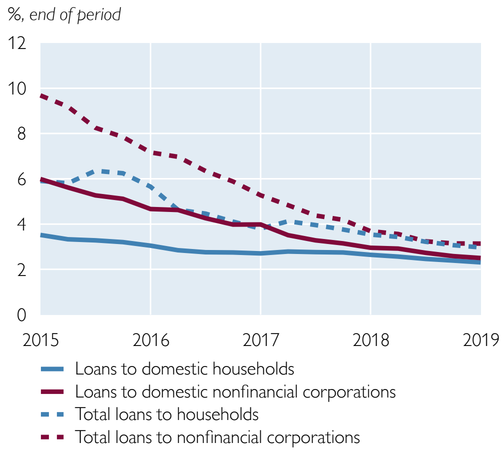
Lending to nonfinancial corporations – especially the real estate sector – and mortgage loans were driving loan growth in Austria in 2019, with the former gaining further momentum in 2020. Loan growth in Austria continued to be strong in 2019, with the annual growth of loans to domestic nonfinancial corporations remaining above 6% and the construction, real estate and housing sectors accounting for almost 60% of domestic corporate loan growth. Especially savings banks and cooperative banks recorded above-average loan growth rates in this segment. The growth of loans to households accelerated to more than 4% due to increasing volumes of mortgage loans (+5.7%). Unlike in many other European countries, consumer loans stagnated (+0.6%). In the first three months of 2020, lending by Austrian banks to domestic nonfinancial corporations gained further impetus due to crisis-related short-term funding needs, and lending to households maintained its momentum.[3]

Loan quality at Austrian banks improved further in 2019, as NPLs were reduced and loan volumes grew. As Austrian banks continued to profit from a still positive macroeconomic environment, the NPL ratios in both the

[3] *See also the section "Corporate and household sectors in Austria: mounting vulnerabilities in the wake of the crisis."*

Chart 3.3

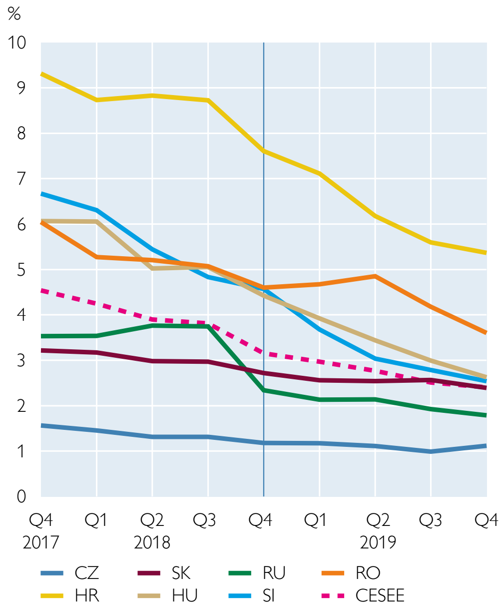
NPL ratios of Austrian banks



Source: OeNB.

Chart 3.4

NPL ratios of Austrian banks' subsidiaries in selected CESEE countries



Source: OeNB.

domestic and the foreign business continued their downward trend. The quality of the loan portfolio in Austria improved on a broad basis in 2019: The NPL ratio of loans to households and to nonfinancial corporations improved to 2.3% and 2.5%, respectively. The consolidated figures, which include cross-border business and activities of foreign subsidiaries, were approximately 65 basis points higher in both cases. Two-thirds of the improvement in the domestic and the consolidated NPL ratios came from a reduction in NPLs, while the remainder was due to loan growth.

Coverage ratios continue to be comfortable, despite modest provisioning in 2019. Besides low NPL ratios, Austrian banks also displayed comfortable coverage ratios, as more than 60% of all domestic NPLs are covered by provisions. However, due to modest provisioning in 2019, this ratio fell slightly compared to the previous year-end.

Loan quality at Austrian banking subsidiaries in CESEE continued to improve in 2019, but heterogeneity at the country level remains. In 2019, the overall NPL ratio of Austrian banking subsidiaries in CESEE dropped from 3.2% to 2.4%. Improvements were evident in all countries but strongest in Croatia and Slovenia, where progress was mainly due to NPL portfolio sales and positive market developments. Notwithstanding these improvements, loan quality remains very heterogenous across CESEE host countries. The NPL ratio continued to be very low, for instance, in the Czech Republic (1.1%), but was still elevated – albeit improving – in Croatia and Romania (5.4% and 3.6%, respectively). On a positive note, the already healthy NPL coverage ratio of Austrian banking subsidiaries in CESEE increased to 67% in 2019, up from 64% at the end of 2018.[4]

[4] *Defined as the ratio of risk provisions for NPLs to total gross NPLs.*

The quality of FX loans at Austrian banking subsidiaries in CESEE has improved significantly but continues to be weaker than the quality of local currency loans.[5] In 2019, the NPL ratio of FX loans dropped by 1.6 percentage points to 4.9%. The strongest decrease was observed for U.S. dollar-denominated loans, whose NPL ratio came down from 5.7% to 3.2%. Nonetheless, FX loans continue to be of weaker credit quality than local currency loans, whose NPL ratio was 3%.

Despite these positive developments, the improvement in loan quality at Austrian banks lost momentum in 2019, and the coming years will be challenging, as the COVID-19 crisis will be taking its toll. Even though massive fiscal measures, such as loan guarantees and support for short-time work, as well as loan repayment moratoria will be temporarily cushioning the worst effects of the COVID-19 crisis on borrowers' ability to pay, a deterioration of loan quality and rising provisioning needs are likely to put downward pressure on banks' profitability over the medium term, especially when support measures expire. Therefore, it remains paramount that banks monitor the credit quality of their portfolios and proactively detect potential signs of borrowers becoming unlikely to pay.

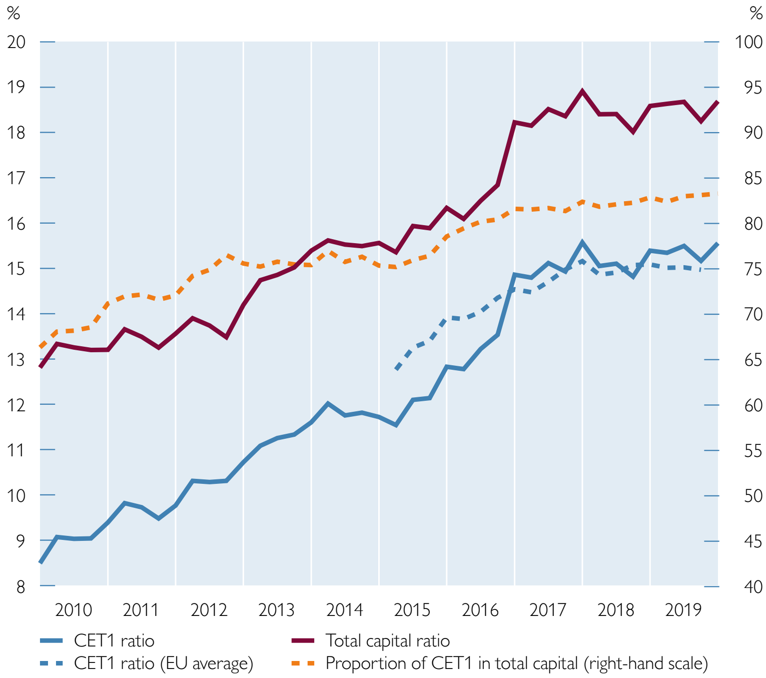
Austrian banks' capitalization rose only slightly in 2019

Austrian banks' common equity tier 1 (CET1) ratio reached 15.6 % at the end of 2019. This level represents a slight increase of 17 basis points year on year, but overall, it is fairly similar to the levels witnessed over the last two years and in line with developments in the EU banking sector (see chart 3.5). However, Austrian banks improved the quality of their capital, as the proportion of the highest quality capital (CET1) in total capital rose from two-thirds in 2009 to more than 80% by the end of 2019. The Austrian banking sector's leverage ratio (on a fully phased-in basis) stood at 7.6 % at end-2019, virtually unchanged from 2018.

When it comes to changes in CET1 capital and risk-weighted assets (RWAs), the past decade can be divided into two distinct periods. Until 2016, the RWAs in the Austrian banking system dropped substantially, while at the same time, banks

Chart 3.5

Consolidated capital ratios of the Austrian banking sector



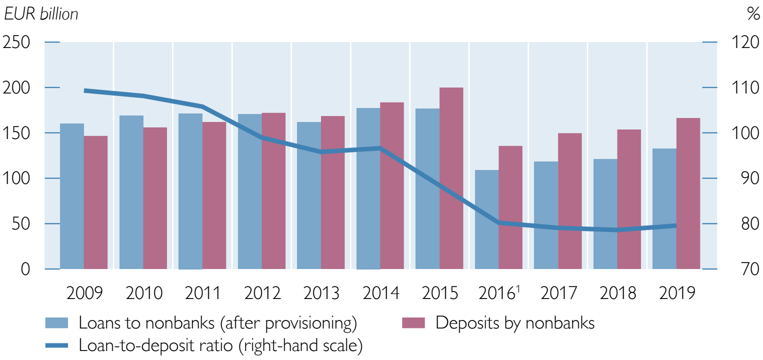
Source: OeNB, ECB.

Note: The large jump in Q4 2016 was a one-off effect due to restructurings at UniCredit Bank Austria.

[5] *Loans to households and nonfinancial corporates.*

Chart 3.6

Loan-to-deposit ratio of Austrian banks' subsidiaries in CESEE



Source: OeNB.

Note: All data as of year-end.

[1] *From 2016: excluding the subsidiaries of UniCredit Bank Austria.*

were building up CET1. From 2017 onward, however, the buildup of capital went hand in hand with the expansion of RWAs,[6] with the CET1 ratio stabilizing around its current level. After several years of rising capitalization in the wake of the global financial crisis, the new trend points toward a sideways movement.

The funding structure of large Austrian banks' subsidiaries in CESEE remained sustainable in 2019. In line with the Austrian supervisory guidance on strengthening the sustainability of the business models of large internationally active Austrian banks ("Sustainability Package") adopted in 2012, the OeNB monitors the stock and flow loan-to-local stable funding ratios of Austria's largest banks' foreign subsidiaries.[7] As of end-2019, all 23 monitored subsidiaries of Erste Group Bank and Raiffeisen Bank International had a sustainable local refinancing structure, which will support financial stability during the COVID-19 crisis. The aggregate loan-to-deposit ratio of all Austrian banking subsidiaries in CESEE (see chart 3.6) reflects a similarly positive picture. Over the past decade, it declined from 109% at the end of 2009 to 80% by the end of 2016, where it remained until the end of 2019.

[6] *Between end-2016 and end-2019, consolidated RWAs rose by 10%. This was caused by total assets rising by 9% over the same time period, as total loans (including leasing) expanded by 15%.*

[7] *For further details, see https://www.oenb.at/en/financial-market/financial-stability/sustainability-of-large-austrian-banks-business-models.html.*

Box 1

Key results of the IMF Financial Sector Assessment Program (FSAP) confirm risk resilience of Austria's banking sector

In 2019, the International Monetary Fund (IMF) conducted an in-depth analysis of the Austrian financial sector.[8] *It focused on key risks to macrofinancial stability, the legal and regulatory framework for financial stability, resources of national institutions to cope with a financial crisis as well as improvements in anti-money laundering and anti-terrorism financing (AML/CFT). In essence, Austria was given an excellent report as regards the stability of its financial system as well as the supervisory structure and measures in place.*[9]

According to the IMF-OeNB stress test, the Austrian banking sector is resilient to severe macrofinancial shocks, *as banks have built up sizable capital buffers. Nonetheless, from a macroprudential perspective, structural systemic risks continue to exist due to the large size of the banking system and its complex ownership structures, high interconnectedness and some banks' strong reliance on profits from their subsidiaries in CESEE.*

Austria's macroprudential authorities have proactively addressed financial stability risks based on a comprehensive analysis framework. *Furthermore, the future addition of the systemic risk buffer (SyRB) and the other systemically important institutions buffer will enhance the effectiveness of these two complementary buffers. The IMF suggests that the high dependence on profits from CESEE could be considered more explicitly in calibrating the SyRB, and that the OeNB's role in the Austrian Financial Market Stability Board (FMSB) should be strengthened by increasing its voting power and entrusting it with the board's chair.*

The IMF assessed that the systemic risk from residential real estate lending continued to increase.[10]*The FMSB's guidance on sustainable real estate financing is key in addressing vulnerabilities.*[11] *But if the risk profile of banks' lending does not improve, further binding regulatory requirements should be considered in the near term, the IMF suggests. Furthermore, data gaps in (commercial) real estate lending should be closed to identify potential financial stability risks in a timely manner.*

The IMF also recommends building additional supervisory resources and deepen analyses in several fields, *such as financial stability (e.g. lending to nonfinancial corporations), stress testing (including second-round effects), insurance supervision and AML/CFT.*[12]

Macroprudential supervisory activities in Austria

Systemic risks arising from real estate financing continued to increase in 2019. In 2019, growth in real estate lending accelerated noticeably as real estate prices continued to rise and interest rates remained low. This drove up the share of real estate finance and mortgage loans in the balance sheets of Austrian banks (to 15% and 29%, respectively) at a time when margins were dropping due to tighter

[8] *The FSAP is a key instrument of the IMF's surveillance activities. In jurisdictions with financial sectors deemed by the IMF to be systemically important (e.g. Austria), financial stability assessments under the FSAP are a mandatory part of Article IV surveillance and are supposed to take place every five years. https://www.imf.org/external/np/fsap/fssa.aspx.*

[9] *See https://www.imf.org/en/News/Articles/2020/01/31/pr2027-austria-imf-executive-board-concludes-2019-financial-system-stability-assessment.*

[10] *See the subsection on macroprudential supervisory activities in Austria for further details on mortgage lending.*

[11] *See https://www.fmsg.at/en/publications/press-releases/2018/17th-meeting.html.*

[12] *In its Staff Concluding Statement of the 2020 Article IV mission (March 3, 2020), the IMF states that "some progress was already made on the FSSA recommendations in the areas of crisis management, banking supervision and macroprudential policy." See https://www.imf.org/en/News/Articles/2020/03/03/msc030320-Austria-Staff-Concluding-Statement-of-the-2020-Article-IV-Mission.*

competition. In addition, borrowers of new housing loans granted in Austria appear to exhibit high debt service-to-income and debt-to-income ratios. In line with its financial stability mandate, the OeNB will continue to carefully evaluate whether the conditions for an activation of macroprudential instruments are met and whether a recommendation to the FMSB for the preemptive activation of measures is warranted. However, it is expected that real estate lending activity will slow down in 2020 as a result of the COVID-19 outbreak. Nevertheless, the uncertainty regarding the impact of the COVID-19 pandemic on the Austrian financial system highlights the importance of banks' risk-bearing capacity and sustainable lending standards.

The systemic risk buffer (SyRB) and the other systemically important institutions (O-SII) buffer will become additive from end-2020. In April 2019, the European legislator adopted the banking package, which includes amended rules regarding the macroprudential toolkit that have to be implemented by the end of 2020 at the latest. The new rules will increase authorities' flexibility in the use of the SyRB and the O-SII buffer. Moreover, the amended framework delineates the scope of these two buffers. On the one hand, the application of the SyRB has been clarified. The SyRB should only address risks in the banking sector that do not include moral hazard related to too-big-to-fail problems at the global, domestic or EU levels. On the other hand, due to this clear-cut distinction, the two buffers will become additive.

Since the introduction of the O-SII buffer and SyRB, the OeNB has followed a complementary approach. The two buffers address different systemic risks and are calibrated with a view to avoiding potential overlaps. While the O-SII buffer addresses the risk a bank may pose to the system, the so-called too-big-to-fail problem, the SyRB addresses the risk the banking system may pose to a bank. In the FSAP assessment (see above), the IMF concluded that the complementarity of the O-SII buffer and the SyRB will become fully effective when the two buffers become additive. However, even though the buffers address different risks, their correlation would enable supervisors to reduce buffer rates while maintaining the level of effectiveness. Hence, the OeNB has developed two approaches to quantify the potential reduction in the O-SII buffer and SyRB rates. In its meeting in March 2020, the FMSB had already countered market uncertainty by ruling out significant increases in the combined buffer requirement as of 2021 by an adequate phase-in arrangement. The latter also contributes to mitigating the medium-term effects of the COVID-19 shock.

In a recent evaluation, the OeNB has found the Austrian SyRB to have been very effective in mitigating structural systemic risk in Austria since its implementation in 2016. Since 2015, the CET1 ratio of Austrian banks has risen by 2.3 percentage points, while lending in Austria and the core markets in CESEE has grown dynamically. The SyRB has improved the resilience of the Austrian banking system, resulting in a substantial improvement in international institutions' and rating agencies' risk assessment of the Austrian banking sector. In addition, macroprudential buffers put Austrian banks in a good position to cope with the negative consequences of the COVID-19 pandemic. Also, the SyRB is an important instrument for enhancing the credibility of resolution and for mitigating any potential negative side effects of resolution.

Box 2

The ECB's Targeted Review of Internal Models (TRIM): lessons learned and impact on Austria's large banks

TRIM enhanced the credibility and confirmed the appropriateness of internal risk models, which are of great importance for banks' risk management. *Consuming almost 10% of the Single Supervisory Mechanism's (SSM) budget, TRIM has been the largest initiative of the SSM in cooperation with national competent authorities to date. The project, conducted between 2016 and 2020, marks an important milestone toward raising the quality and comparability of outcomes of approved Pillar I models on credit, market and counterparty credit risk in use at ECB-supervised significant institutions (SIs). It does so by harmonizing supervisory practices relating to these internal models in the SSM and ensuring their compliance with (consistently interpreted) regulations. Two of TRIM's main objectives are to reduce unwarranted (i.e. non-risk-based) variability of own funds requirements caused by previous inconsistent interpretations of the regulatory framework by both banks and supervisors and to create a level playing field among SIs in the use of their internal models.*[13]

TRIM has eliminated differences in supervisory practices and confirmed the effectiveness of the on-site strategy to internal model supervision. *TRIM involves 200 on-site model investigations across 65 SIs, covering all market and counterparty credit risk models and about 70% of credit risk exposures. Between 2017 and 2019, the OeNB conducted 13 of these investigations. One of the lessons learned from TRIM is that models that have not been subject to an on-site investigation over an extended time period tend to exhibit a higher number of shortcomings. To ensure SSM-wide consistency and transparency and support the execution of the aforementioned on-site investigations, the ECB published its "ECB Guide to Internal Models." It explains the ECB's supervisory understanding of existing regulation concerning topics within the assessment scope of TRIM and provides a common methodological assessment approach. Because of its model-related expertise and high-quality model supervision, the OeNB was closely involved in these activities will contribute to their consistent future progression.*

Austrian SIs that use internal models are (on average) less affected by issues identified by TRIM. *The on-site model investigations and harmonization efforts conducted under TRIM have resulted in a number of SIs being required to implement obligations and – in the majority of cases – immediate capital add-ons. At the overall SSM level, the increase in own funds requirements is moderate, but, as expected, the extent to which individual institutions are affected varies. Austrian SIs that apply internal models have clearly profited from the OeNB's well-established, intense and high-quality model supervision. Consequently, they have been (on average) less affected by supervisory measures as a result of TRIM to date.*

Although both SIs and supervisors have already invested significant resources in TRIM, further efforts will be necessary to implement and address the findings of TRIM.

FX lending by Austrian banks

FX loans in Austria have continued to decline. Thanks to supervisory measures, FX loans do not currently present a systemic risk to the Austrian banking sector. In March 2020, the volume of outstanding FX loans to domestic households fell by 13% (exchange rate adjusted, year on year) to EUR 13.4 billion. The lion's share of these loans is denominated in Swiss francs, and their share in total outstanding loans to households dropped by 0.9 percentage points to 7.9% year on year. Despite their ongoing reduction, FX loans to households remain a risk, as

[13] *See https://www.bankingsupervision.europa.eu/banking/tasks/internal_models/trim.*

about three-quarters are bullet loans linked to repayment vehicles. Such loans may face a funding shortfall at loan maturity in case of unfavorable exchange rate movements and/or underperforming repayment vehicles. However, there are also several mitigating factors. Typically, FX borrowers have higher income levels, and FX loans are usually secured by real estate. In order to monitor the changes in these loan segment, the OeNB – in cooperation with the FMA – conducts an annual survey among a representative sample of Austrian banks. The results of this year's survey are expected to be available in late summer 2020.

The appreciation of the Swiss franc is putting pressure on FX borrowers. Since September 2008,[14] the Swiss franc has appreciated by around 50% against the euro (as of March 2020). This implies that, for instance, a borrower who took out a Swiss franc bullet loan of EUR 200,000 in September 2008 would have to repay EUR 300,000 (in addition to the interest that also become due). Given recent market turbulences caused by COVID-19 and the oil price decline, the Swiss franc – a traditional safe haven currency – may appreciate even further. The OeNB therefore continues to recommend that banks and borrowers intensify bilateral negotiations to find tailor-made solutions in order to mitigate risks arising from these loans.

Austrian banking subsidiaries in CESEE have continued to reduce their outstanding FX loans to households. In 2019, the volume of FX loans to CESEE households fell by 4% (exchange rate adjusted) to EUR 10 billion, and their share in total loans to households dropped from 15% to 13%. Meanwhile, the volume of FX loans to nonfinancial corporations remained broadly unchanged at almost EUR 20 billion, and their share in the corporate loan segment dropped from 39% to 37%. The fact that FX loans continue to be important in the corporate segment can partially be explained by the natural hedge of many corporations that also earn income in foreign currency. The euro is the dominant loan currency by far, accounting for 83% of all FX loans to households and nonfinancial corporations. Loans denominated in Swiss francs and U.S dollars account for 9% and 8%, respectively. The risks stemming from Swiss franc loans have declined considerably and do not currently pose a major risk to financial stability. Nonetheless, legal and political uncertainties remain, especially in Poland.

[14] *Shortly before the FMA strongly recommended that banks refrain from granting new FX loans to households in Austria.*

Box 3

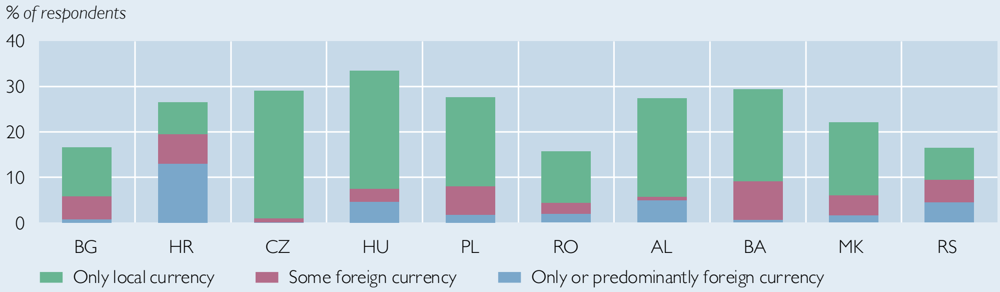
FX loans of households in CESEE: do they still pose a risk?[15]

FX lending to households in CESEE countries has declined since the global financial crisis but remains close to 50% of total loans in some countries. *Recent exchange rate fluctuations in several CESEE countries once again raise the question whether the remaining FX loans of households increase financial vulnerability by exposing households to exchange rate risk and by putting concentration risk on banks because otherwise heterogeneous households are subject to the same risk factor. Survey evidence from the OeNB Euro Survey[16] helps to shed light on heterogeneities within countries that may render some households more vulnerable to exchange rate fluctuations than others.*

The latest two Euro Survey waves of fall 2018 and 2019 show that across countries, an average 8% of individuals have an FX loan *(chart 3.7). The percentage is highest in Croatia[17], where 19% have FX debt. On the aggregate level, evidence on the purpose of loans is limited. The OeNB Euro Survey reveals that in Romania and Serbia, consumption loans are the most frequent form of loans to households – almost every second borrower has a consumer loan. In Croatia and the Czech Republic, the percentage of borrowers with consumer loans is close to that of borrowers with mortgages. While in Croatia, however, the vast majority of both mortgages and consumer loans are denominated in FX or indexed to FX, in the Czech Republic, the share of FX loans is negligible for both loan purposes. Serbia has an even higher share of FX mortgages than Croatia, and its share of FX consumer loans is 49%. In Croatia and in Serbia, the majority of mortgages are denominated in foreign currency. Survey evidence also provides evidence on how loans are secured: Loan collateral is the most frequent form of loan security, followed by loans secured by third-party guarantors. In all countries, the percentage of collateralized loans is higher for FX loans than for local currency loans. Loans that are not secured by collateral or a third-party guarantor are more frequently denominated in local*

Chart 3.7

Incidence of local and foreign currency loans among households



Source: OeNB Euro Survey, 2018-2019

[15] *For the full version of this analysis, see Konjunktur aktuell - Juli 2020 at https://www.oenb.at/Publikationen/Volkswirtschaft/konjunktur-aktuell.html.*

[16] *For more information on the OeNB Euro Survey see: https://www.oenb.at/en/Monetary-Policy/Surveys/OeNB-Euro-Survey.html. In this analysis, we use data from 2018 and 2019, drawing on a total of around 20,000 observations. However, not all respondents have loans and the share of respondents with FX loans is lower. For some of the descriptive statistics presented, the underlying number of observations is therefore rather low. All descriptive statistics are weighted. Weights are calibrated on Census population statistics for age, gender, region, and, where available, on education and ethnicity. Weights are calibrated separately for each wave and country. The OeNB Euro Survey collects information about all loans an individual currently holds as well as detailed questions about the largest most important loan. It does not contain information on loan amounts or installments for individual loans.*

[17] *Both Croatia and Bulgaria plan to join the ERM II, which would reduce the risk of exchange rate shocks for households with foreign currency debt.*

Table 3.1

Are foreign currency borrowers hedged?

	Household income, equivalence scale		Percentage of borrowers with regular income in EUR		Percentage of borrowers who regularly receive remittances		Percentage of borrowers with savings deposits in foreign currency		Percentage of borrowers with cash savings in foreign currency	
Borrowers with loan in	LC	FX	LC	FX	LC	FX	LC	FX	LC	FX
	PPP EUR		%							
Bulgaria	277	266	3	4	4	3	4	6	24	21
Croatia	390	403	5	5	1	3	21	22	46	48
Hungary	418	394	2	1	1	1	2	4	9	18
Poland	338	312	2	4	1	12	4	12	28	38
Romania	242	260	1	2	2	2	3	1	21	27
Albania	114	195	4	13	9	17	8	42	29	67
Bosnia and Herzegovina	224	260	5	3	3	2	3	3	18	17
North Macedonia	154	162	4	6	2	5	11	18	47	60
Serbia	197	238	4	5	2	5	6	15	36	42

Source: OeNB Euro Survey, 2018–2019.

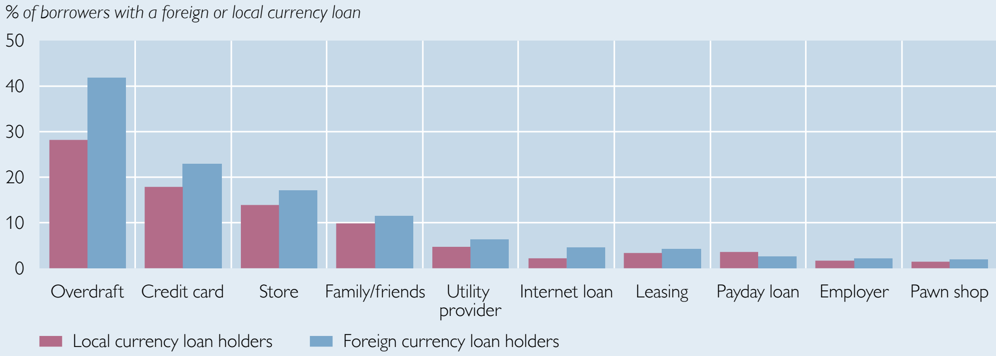
Note: LC = local currency, FX = foreign currency.

currency. However, 23% of FX loans are secured by third-party guarantees granted by individuals.

***Table 3.1 provides an indication to what extent FX borrowers[18] would be hedged in case of an exchange rate shock.** It shows that FX borrowers' household income (in equivalence terms) is higher than that of local currency borrowers in 6 out of 9 countries.[19] In several CESEE countries that do not have the euro as a legal tender it is never-*

Chart 3.8

Other sources of debt



Source: OeNB Euro Survey, 2019.

[18] *As the percentage of FX borrowers always has been negligible in the Czech Republic, the descriptive statistics in this section exclude the Czech Republic.*

[19] *The information on the income level alone is not informative as it needs to be put into perspective with the monthly debt service burden of the household. For an analysis of households' debt service-to-income ratio see Riedl, A. (2019). Household debt in CESEE economies: a joint look at macro- and micro-level data. In: Focus on European Economic Integration Q4/2019. OeNB. The analysis does not focus on FX loans but looks at all loans to households.*

theless quite common that households receive income in euro. Table 1 shows that although FX borrowers on average have higher incomes, only a small percentage regularly receives FX income which could serve as a hedge against exchange rate shocks. The majority of FX borrowers do not have FX savings. Some FX borrowers regularly receive remittances from abroad, however, it is likely that these inflows could be affected by economic downturns in other countries.

Beyond FX hedging, borrowers may be hit particularly hard by exchange rate fluctuations if they must pay back more than the original amount taken out as an FX loan. *Chart 3.8 describes other sources of indebtedness. It shows that 40% of FX borrowers also have overdraft debt. The percentage is significantly lower for local currency borrowers. In addition, 23% of FX borrowers have credit card debt compared to 18% of local currency borrowers. In fact, compared to local currency borrowers, FX borrowers more frequently owe money in any of the possible forms listed in chart 3.8. The exceptions are payday loans, which, however, account for less than 5% for both FX and local currency borrowers. Also, some borrowers owe money to more than one of the possible sources and, again, the percentage of borrowers who owe money to two or more sources is higher for FX borrowers than for local currency borrowers.*

Experiencing an exchange rate shock increases the probability that FX borrowers fall into loan arrears. *The increase in the probability depends on the magnitude of the shock. During February and March 2020, exchange rate changes were moderate compared to earlier crisis periods. However, this may change as the COVID-19 crisis unfolds.*

Austrian nonbank financial intermediaries posted capital gains in 2019

Persistently low yields continue to be a challenge to the life insurance sector, but overall capitalization is still comfortable. Life insurance premiums have decreased sharply since their all-time high in 2010 (from EUR 7.4 billion to EUR 5.4 billion). Given that the maximum guaranteed rate on a traditional life insurance policy has been unchanged at 0.5% since 2017, some life insurers continue to shift their business mix toward products that are directly linked to market performance and whose investment risk is borne by policyholders. Nevertheless, the share of traditional life insurance policies in all life insurance premiums remains rather stable at about three-quarters. Despite the adversities the sector has been faced with, the investment return of Austrian life insurance companies is higher than the average guaranteed rate on the stock.

The sector's total premium volume of EUR 17.6 billion consists of EUR 9.8 billion revenues from property and casualty insurance policies, EUR 5.4 billion from life insurance policies and EUR 2.3 billion from health insurance policies. The underwriting result increased by 22% in 2019 compared with 2018, and the financial result rose by 23%. As a consequence, the result from ordinary business activities improved to EUR 1.7 billion. By the end of 2019, Austrian insurance companies were well capitalized, with a median solvency capital requirement ratio of 238%. Bonds accounted for almost a quarter of the Austrian insurance sector's total assets in 2019, followed by collective investment undertakings (nearly one-fifth) and holdings in related undertakings (also nearly one-fifth). Compared to 2018, changes in assets were reflected in collective investment undertakings and property, with both slightly increasing in importance while holdings in related undertakings and cash were reduced.

Austrian pension funds enjoyed high returns in 2019. Assets under management by Austrian pension funds increased by 13.6% (year on year) to EUR 24.3 billion, and the number of beneficiaries (prospective and current recipients) increased by 3.4% to 980,000. Currently, 111,000 beneficiaries receive a pension under an occupational pension scheme. The largest exposure of the sector are bonds (43% of the portfolio), followed by stocks (34%), and almost all assets are invested via investment funds. In 2019, the overall return on investment of Austrian pension funds was 11.6%, compared to an average 4.3% p.a. over the past ten years.

Austrian investment funds realized capital gains in 2019. The net asset value of Austrian investment funds was EUR 195 billion by the end of 2019. Driven by capital gains, the funds' assets increased by 12.2% or EUR 21.2 billion compared to the previous year. Net inflows accounted for EUR 4.3 billion.

Austrian nonbank financial intermediaries are able to cope with the difficult financial situation. In the COVID-19 crisis, the nonbank financial sector is facing difficult conditions, both in terms of navigating challenging market conditions and maintaining operations. However, recent stress tests for the insurance sector have shown that the sector is well capitalized and able to withstand severe but plausible shocks to the system. In addition, increasing market volatility is expected to affect the sector substantially only if adverse developments persist over a longer period.