

Management summary

Rebound in global economic activity in late 2020

Despite the resurgence of the COVID-19 pandemic, the worldwide economic recovery was rapid in the second half of 2020, but uneven across demand components. On a global scale, economic activity returned to pre-pandemic levels in the final quarter of 2020 and has continued to grow in early 2021. The recovery builds on more favorable economic and financial conditions as governments and central banks have been providing generous support. In the euro area, however, the recovery has been delayed to the second quarter against the background of an initially slow vaccination campaign. Inflation has increased recently and, according to ECB projections, will stay volatile but moderate until the end of the year.

The spread of coronavirus in spring 2020 brought economic activity in Central, Eastern and Southeastern Europe (CESEE) to a sudden halt. Yet, the recession was less severe than in the euro area, as CESEE benefited from a rebound of world trade in the second half of 2020 that allowed industrial dynamics to break away from trends in most other sectors. The COVID-19-related slump in economic activity was met with a strong policy reaction, and monetary policy and financial conditions remained highly accommodative throughout 2020. Some countries, however, have had to raise interest rates in response to rising inflation in recent months. Despite the economic turbulences, banking sectors in CESEE performed reasonably well in 2020. Profitability declined notably but remained positive throughout the region. Regulatory action, monetary policy measures and public guarantee schemes have supported lending activity and prevented a stronger increase in nonperforming loans (NPLs).

Corporate and household sectors in Austria strongly affected by the pandemic

Economic activity in Austria has been strongly hampered by the COVID-19 pandemic. Yet, due to large-scale government support measures, nonfinancial corporations' profitability, as measured by gross operating surplus, deteriorated only slightly in 2020. While internal financing increased, external financing volumes decreased in 2020, reflecting negative equity financing and reduced debt financing. Bank loans remained a central tool for maintaining companies' liquidity during the pandemic, facilitated by the Eurosystem's comprehensive monetary policy instruments, payment moratoria and government guarantees for loans. Yet, after a spike in the first two months of the pandemic, the annual growth rate of loans to nonfinancial corporations moderated slightly. This reflected the declining use of COVID-19-related moratoria, the sizable liquidity buffers that had been built up in the first phase of the pandemic and muted corporate investments. In contrast, corporate bond issuance increased substantially in 2020. As a result of the rise in debt, the aggregate corporate sector's consolidated debt-to-income ratio increased. However, this rise was accompanied by a strong buildup of liquid assets (cash and deposits). Moreover, insolvency numbers have fallen significantly since the start of the pandemic due to government support measures, but lagged effects are likely to materialize when these measures are eventually phased out.

The pandemic and the related containment measures also significantly dampened household income. In parallel, the growth of bank lending to households subsided slightly. While consumer loans were down considerably in line with the lower consumption of durables, growth in housing loans remained buoyant amid favorable financing conditions and continuing demand for housing. Both the increase

in outstanding debt and the reduction of disposable income contributed to a rise in the aggregate household debt-to-income ratio. However, a significant share of household debt is held by households with higher incomes, which are more likely to have sufficient funds to service their loans. Residential property prices in Austria continued to rise in 2020 and early 2021, further deviating from their fundamentally justified values as implied by the OeNB fundamentals indicator for residential property prices.

Austrian financial intermediaries continue to support the economy; precautionary provisioning affected banks' profits in 2020

Fortified by improved liquidity and a doubling of capital ratios since the global financial crisis, banks entered the pandemic in a state of greater resilience. Austrian banks' macroprudential capital buffers have increased the stability of the financial system and improved market confidence, a fact which was also confirmed by the rating agency Moody's in April 2021. Greater resilience and public support measures enabled banks to continuously perform their economic function and support the economy during the pandemic, allowing them to alleviate many negative effects. Nevertheless, banks were not able to shield themselves from the effects of the broad-based downturn that took a heavy toll on their annual profit.

Fiscal support and regulatory policy measures have helped to avoid any severe feedback loops between the real economy and the financial system. However, the prospect of deteriorating credit quality has led banks to step up precautionary measures by significantly increasing credit risk provisioning (albeit from very low levels). At the same time, the low interest rate environment has put further pressure on banks' interest margins and fueled a global rebound in financial asset prices.

Recommendations by the OeNB

In an environment of persistent uncertainty, both about the further course of the pandemic and its implications for the economy, the OeNB recommends that banks take the following measures:

- Focus on a solid capital base, i.e. avoid share buybacks and carefully consider profit distributions (dividends, management bonuses) in accordance with European recommendations.
- Continuously analyze borrowers' solvency, especially after the expiration of COVID-19-related support measures, to ensure the validity of credit risk indicators and an adequate level of loan loss provisioning.
- Apply sustainable lending standards, particularly in real estate lending, both in Austria and in CESEE, and comply with the quantitative guidance issued by the Financial Market Stability Board.
- Continue efforts to improve cost efficiency and operational profitability, even under the currently difficult circumstances.
- Further develop and implement strategies to deal with the challenges of digitalization and climate change.