CEE banks set to benefit as investors start focusing on growth prospects

19.09.2013

Czech Republic – stable asset quality, average NPL ratio at 6%; loan-to-deposit ratio among the lowest in Europe

Poland – NII to rebound in 3Q13e; investment loans picking up, retail lending to make headway in 4Q13

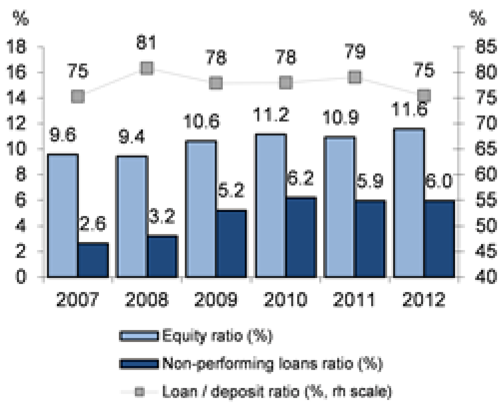
Hungary – deleveraging hit bottom in 2Q13, SME loan-demand picking up; NPLs still a drag

Romania – housing loans the only growth segment, NPLs still high; GDP growth to improve outlook for the sector

Top 10 CEE + Turkey picks: BZ WBK, Bank Pekao, PKO BP, Raiffeisen Bank International, Komercni, Banca Transilvania (RO), AIK Banka (RS) and Komercijalna Banka (RS), Yapi Kredi Bank, Halkbank (TR)

The first green shoots of recovery in the Eurozone are gradually shifting investor focus towards a growth-play and CEE banking sectors are set to benefit from this, according to Erste Group's CEE banking sector report released today. "All in all, we see the structural advantages in countries like Poland and the Czech Republic providing the basis for accelerated growth in 2014 and beyond. Decreasing risk costs coupled with accelerating revenue generation from rising volumes and improved net interest margins, as well as tight cost control are likely to trigger bottom line growth starting next year. Threats for the profitability of banks in those countries could come from the fiscal side rather than the operating side (banking tax discussions, corporate tax increase). In Hungary, Romania and Serbia the major challenge is slashing risk costs and finding a balance between growth, margins and risk costs to achieve sustainable profitability. Capitalization continues to be healthy and is therefore a strong pillar for these developments," explains Günter Hohberger, CEE banking analyst at Erste Group.

The first green shoots of recovery in the Eurozone are gradually shifting investor focus towards a growth-play and CEE banking sectors are set to benefit from this, according to Erste Group's CEE banking sector report released today. "All in all, we see the structural advantages in countries like Poland and the Czech Republic providing the basis for accelerated growth in 2014 and beyond. Decreasing risk costs coupled with accelerating revenue generation from rising volumes and improved net interest margins, as well as tight cost control are likely to trigger bottom line growth starting next year. Threats for the profitability of banks in those countries could come from the fiscal side rather than the operating side (banking tax discussions, corporate tax increase). In Hungary, Romania and Serbia the major challenge is slashing risk costs and finding a balance between growth, margins and risk costs to achieve sustainable profitability. Capitalization continues to be healthy and is therefore a strong pillar for these developments," explains Günter Hohberger, CEE banking analyst at Erste Group.



Source: CNB, Erste Group Research

Czech Republic – asset quality stable at 6% NPL ratio
Given the positive Czech GDP data for 2Q of +0.6% q/q and the recent pickup in yields to 2.44% for 10y bonds, banks in the Czech Republic expect a fairly improved environment in 2H 13. Retail loan growth is driven by mortgages, with a growth rate of + 3.2% y/y, while consumer loan volumes continued to decline by 1.0% y/y. On the corporate side most of the recent lending activity is related to working capital financing whereas, while the production of new corporate loans is stalling. Deposit growth remains as sound as ever at 4.8% y/y, keeping the loan/deposit ratio at 75%, which is one of the lowest loan/deposit

ratios in CEE. In spite of the recession, the asset quality of Czech banks remains stable with the NPL ratio standing at 6.0%.

Poland – rebound in the NII starting in 3Q13e
In Poland, total loans were up 3.7% y/y in July 2013 (including public institutions), with retail loans up 3.3% and corporate loans up 0.5% y/y. On the corporate lending side the investment loans stock increased for the second month in a row, after six months of y/y declines, which points to prospects for economic recovery. As the regulatory stance regarding consumer loans continues to relax along with the all-time low money market rate, retail lending is expected to speed up towards the end of 2013; the pickup in corporate loans should be driven by growing consumption and hence enhanced investments, additionally supported by EU-financed projects.

NIMs for Polish banks have slightly improved at some banks albeit the falling money market rates as they were able to partly offset the negative effect of low interest rates environment through aggressive re-pricing. In fact, based on the July data, Erste analysts believe that NII has bottomed out and going forward expect it to improve versus 2Q13, due to increasing NIMs, alongside slightly increasing lending volumes.

“In the context of the monetary tightening and interest rates rise, we expect that a 100bps move in the rates would increase NIMs by around 30-40bps at PKO BP, 20-30bps at Pekao and BRE and approx. 10-20bps at BZ WBK.,’’ highlights Magdalena Komaracka, Head of Research at Erste Securities Polska.

The search for improved efficiency may also drive cost cutting in the branch networks as well as further mergers and acquisitions activity. However, Erste analysts don’t expect a dramatic decrease in the number of branches, but rather a change in their focus as well as personnel reductions.

’’We continue to be positive on Polish banking stocks, as we forecast the Polish economy to grow by 2.4% in 2014 after a 1.1% growth rate in 2013, and expect banks to make the most of these developments.’’

Source: National Bank of Poland, Erste Group Research

Download [png; 96.2 KB]

Hungary – deleveraging hit bottom in 2Q13, SME loan demand picking up; NPLs still a drag
The business environment in Hungary remained a drag on banks’ profitability, as the NPL ratio showed a dynamic increase by around 18% by 2Q13, from 4% in 1Q09. Although NPL formation has slowed down in the last four quarters, this trend will not be supported by the announced relief plan for FX mortgage borrowers, which has already increased the uncertainty on the market as borrowers are waiting for the details. Loan-loss provision coverage for 2Q13 was 58% for the overall Hungarian banking system.

More importantly, deleveraging has most likely hit bottom in 2Q13 mainly due to the Funding for Growth Scheme (FGS), which stimulates SME loan demand - some volume increase will be visible in the coming quarters. Due to its good record, the FGS was extended by HUF 2,000bn this month. Erste analysts expect a 2.5% decline in the 2013 overall loan book, after the approx. 6% fall in the first half of the year. A 1% growth is likely next year, with a subsequent +3% in 2015.

On the external funding side, Hungarian banks were able to halve wholesale funding from parent banks over the past five years. By the end of July, external financing fell to CHF 26.8bn, or EUR 21.5bn, from a peak of CHF 66bn or EUR 43bn at the beginning of financial crisis. In CHF terms, the present level is the same it was in 2004; while in HUF terms it is on the 2006 level (due to the depreciation of the Hungarian currency since then).

Romania – housing loans the only growth segment, NPLs still high; GDP growth to improve outlook for the sector
The lending environment has lately mainly been driven by mortgages, with a 6.5% y/y advance. Overall, consumer loans remained in negative territory with an 8.9% y/y contraction due to scarcer demand, whereas corporate loan growth dropped by 2.7% y/y. This points to the fact that the economic environment is still difficult for the time being. Deposit growth remains on a positive trend as household and corporate deposits increased by 1.6% YTD or 2.9% y/y. In terms of asset quality trends, the NPL ratio increased to 20.9% from the 18% reported at end-2012 due to weak lending activity, which did not support the reporting base.

For the first half of 2013, domestic banks reported an aggregated net profit of approx. EUR 258mn (RON 1.15bn) from the EUR 44.8mn (RON 200mn) loss reported in the corresponding period of 2012. Given Romania’s current GDP growth rate of

2.5% 2013 - the 2nd highest in the region after Turkey, its low risk profile in fiscal terms, sound balance of payments and good employment levels, Erste analysts maintain a constructive view on the Romanian banking sector outlook.

Serbia – net interest margins expected to stabilize at 1Q13 level
In Serbia, retail loan growth was 2% y/y, driven largely by household mortgages. However, the overall loan portfolio decreased by 0.4% y/y. On the deposit side, households' savings totaled EUR 82,4mn (RSD 945bn) at the end of 2Q13, up 4.4% y/y. Corporate deposits increased at the same pace to EUR 37.4mn (RSD 429bn). Total capital improved by 3.4% y/y to EUR 51.3mn (RSD 588bn).

The profitability of the banking sector remains moderate at around 5% as of 2Q13, with average NIM expected to stabilize at the levels recorded in 1Q13 after the one-off effect triggered by the new law on penalty interest rates and calculation of compounded interest.

''The Serbian economy got off on the right foot in 2013, with 1Q13 GDP expanding by 2.1% y/y, and 0.7% y/y in 2Q13. Domestic demand had a negative contribution, while net exports were an expectedly robust positive driver. Going forward, the 2H13 figures should be helped by a better agriculture crop versus 2012, supporting our GDP forecast of +1.8% for 2013. Considering the weak domestic demand, banks will retain their cautious approach to lending and will see a flat performance in 2013'', expects Günter Hohberger.

Turkey – loan growth to decelerate to 16% y/y in 2014
Fundamentally, Erste Group analysts remain positive on the long-term economic outlook of Turkey and believe that Turkish banks will differentiate themselves positively on the back of a couple of factors: the strong macroeconomic landscape that they are operating in, high growth potential both on the corporate and consumer side, strong balance sheets with high capitalization ratios and liquidity conditions and as well as relatively high profitability and internal capital generation to fund the expected growth. Moreover, Fed's decision on keeping its asset purchases steady supports a positive outlook. ''On the other hand, the road ahead could be rather bumpy in the short-term due to the uncertainties associated with the global interest rates and the risk appetite of global investors as Turkey's saving gap forced the country to rely on foreign savings. Hence, in the short-term Turkish banks will remain sensitive to global interest rates and their repercussions will be mainly on banks' net interest margins and to a lesser extent on their book values'', explains Can Yurtcan, Head of Research at Erste Securities Turkey.

Regarding the key performance metrics, loan growth is estimated to 24% y/y in 2013 and to decelerate to 16% in 2014. On the funding front, deposits are expected to growth 12% y/y. Turkish banks should keep their focus on funding base diversification via tapping into bond markets and utilizing a higher share of money market funding.

Top 10 CEE + Turkey picks'
Erste Group analysts believe that the Polish economy is likely to recover next year and that banks are a good proxy for that - therefore they are positive on Polish banking stocks. Despite its outperformance, BZ WBK is rated as a buy, as is expected that its outstanding earnings momentum will continue to be boosted by the most recent acquisition of Kredyt Bank. Synergies will help BZ WBK's financials to a greater extent in 2014e and 2015e, which will warrant higher valuation. We rate Bank Pekao as an Accumulate, as we believe that banks' best-in-class capitalization ratio puts the banks in a very comfortable situation for future growth, both organic and through acquisitions. We also think that Pekao will have a relatively high dividend yield (at ca. 6%), while there is also a chance extra dividends will be paid, provided that the regulatory stance gets more favourable. In PKO BP the accumulate rating comes from our assumed synergies from Nordea acquisition and as we also believe that, assuming interest rates were to reverse, the bank should be able to improve its fundamentals.

Apart from Polish banks we have put an Accumulate rating on Raiffeisen Bank International (down from Buy) and the Komercni banka (CZ) from the large caps. After the recent RBI profit warning, we reiterate our view that the capitalization issue might not be solved in the short term in the form of a heavily dilutive capital increase. In our view, a mix of measures based on a medium-term strategy to pay back the state tranche of the participation capital (EUR 1.75bn) by the end of 2017 might be more probable than a substantial rights issue at the current share price. We like Komercni banka as a dividend play (currently 5.5% DY13e) and for the relatively lower valuation multiples compared to its Polish peers (1.6x P/B13e vs. 1.9x for big 4 Polish banks).

From the small caps we give an Accumulate to Banca Transilvania (RO), AIK Banka (RS) and Komercijalna Banka (RS) mainly for relatively low valuation given their solid profitability. As for the Turkish banking stocks, Yapi Kredi Bank and Halkbank are included among Erste analysts' Top-10 picks (both Buy recommendation) thanks to their growth profile and stable profitability outlook as well as attractive valuation levels.

Bank Strategy CEE and Turkey [pdf; 2.9 MB]

CEE and Turkey Bank Strategy [pdf; 810.9 KB]