NATIONAL BANK OF GREECE

SEE-5 Banking Sector Overview 2022 & Outlook

SPECIAL ISSUE

JULY 2023

Romania

Bulgaria

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North Macedonia

Albania

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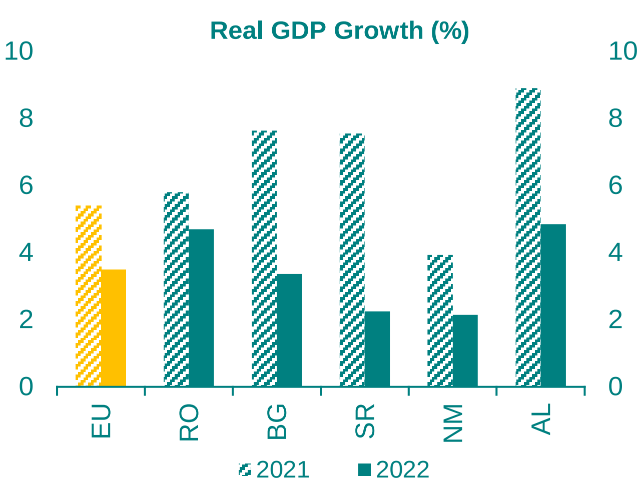
Banking Underpenetration in SEE-5

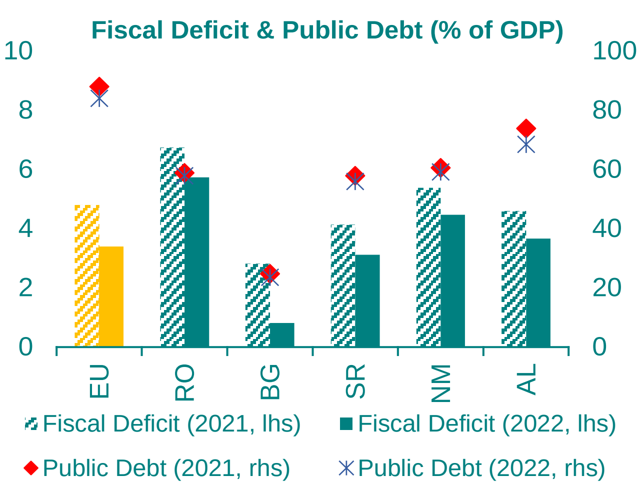
General Information

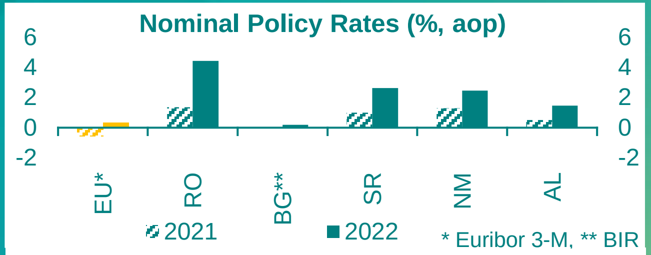
Macroeconomic Environment - 2022 Overview

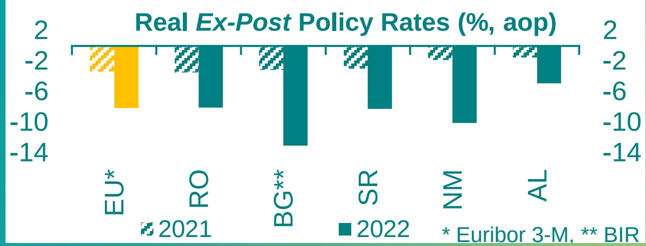
> *SEE-5 banks' operating environment improved in 2022, despite headwinds*

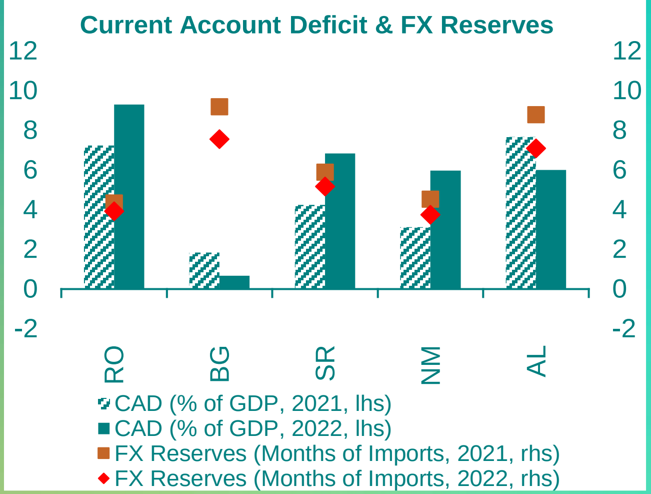
- ✓ The SEE-5 economies saw another year of robust GDP growth in 2022 (up 4.1% following 6.0% in 2021, with the latter attributed to favourable base effects following the full lifting of COVID-19 restrictions), despite the headwinds unleashed by the Russia-Ukraine conflict, in particular the energy crisis. However, starting from late 2022, there have been clear signs of slowdown. Overall, despite the high shares of energy and food in domestic household spending and the economies' relatively low energy efficiency, the SEE-5 region continued to outperform the EU average
- ✓ Higher global commodity prices and their pass-through to core prices, together with resilient demand and the impact of disruptions in global supply chains, sent headline inflation to a record-high of 13.5% on average in 2022 from just 4.4% in 2021
- ✓ Fiscal balances improved in 2022 in SEE-5 economies -- yet remained weaker than their pre-pandemic levels -- as strong inflation-driven growth in tax revenue more than offset higher spending, mostly related to measures cushioning the impact of the inflation crisis. Public debt dynamics benefited from very strong nominal GDP growth, pushing the relevant ratios further down and below the 60% of GDP threshold (with the only exception being Albania)
- ✓ Record-high inflation and heightened uncertainty prompted all regional central banks to withdraw the excess liquidity injected in their markets during the pandemic and hike rates aggressively
- ✓ Unfavourable global commodity prices and resilient domestic demand were translated into wider current account deficits in Romania and N. Macedonia. Against the backdrop of tighter external financing conditions, the latter and Serbia were prompted to recourse to the IMF. In contrast, Bulgaria and Albania saw their external accounts improve, thanks, *inter alia*, to strong tourism activity









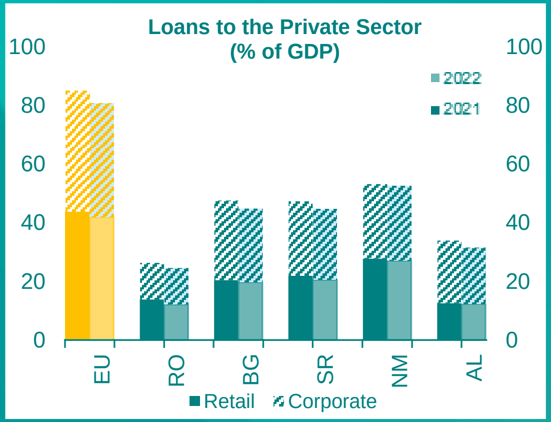


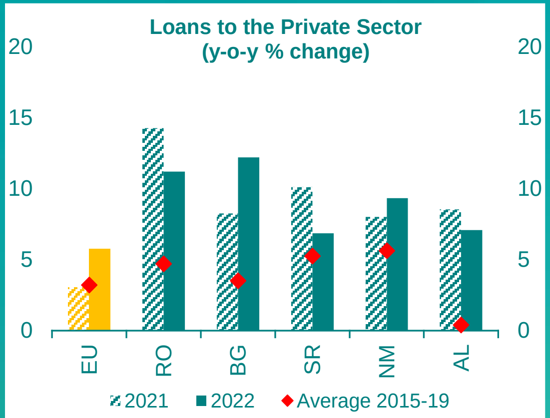
Sources: EBA, National Central Banks & NBG estimates

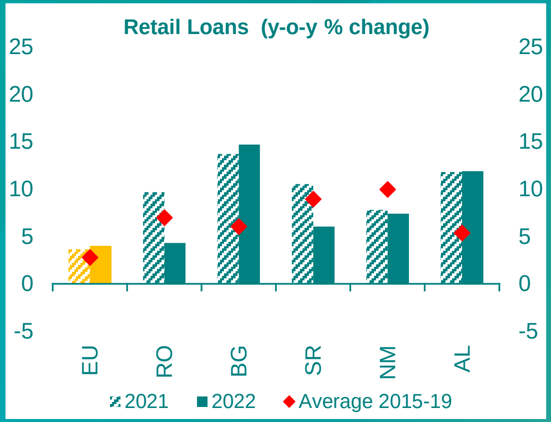
Banking Sector Activity - 2022 Overview

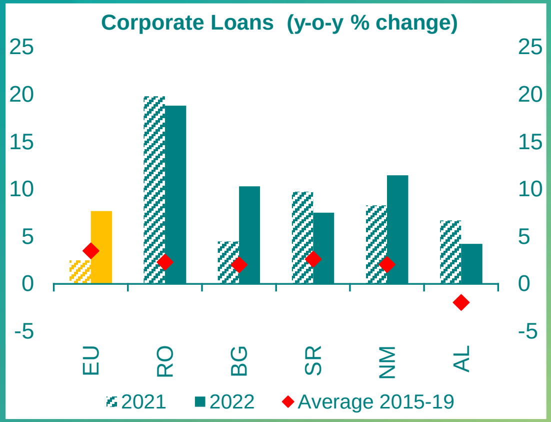
“Credit expansion remained resilient, amid strong economic growth and rising inflation”

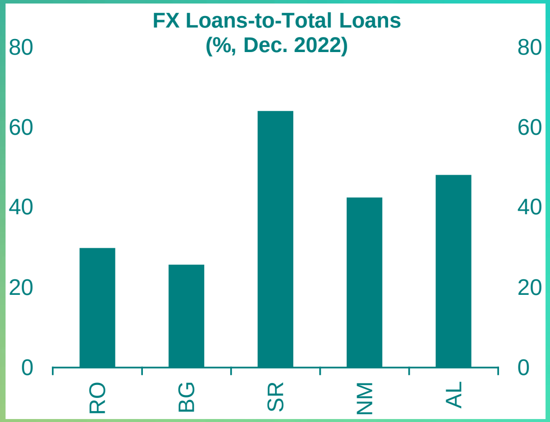
- ✓ Against the backdrop of strong economic growth and rising inflation, credit to the private sector continued to expand at a solid pace in 2022 in SEE-5, despite the full roll-back of state-sponsored COVID-19 support schemes. Credit expansion was stronger in H1:22, while slowed down in H2:22, when monetary policy tightening kicked in
- ✓ From a segment perspective, corporate lending picked up in most of the economies under review, reflecting strong demand for short-term financing, mainly for working capital
- ✓ Still, financial intermediation remains at relatively low levels in SEE-5, especially in Romania and Albania (see also the “Banking Underpenetration in SEE-5” section)
- ✓ The retail segment appears to be the most underpenetrated. On the other hand, the penetration rates in the corporate segment are understated since they exclude a non-negligible amount of lending coming from foreign banks and parent companies
- ✓ In light of the large positive interest rate differential between SEE-5 and the euro area, on the one hand, and higher FX needs, following the jump in global commodity prices, on the other hand, FX lending growth outpaced LC lending growth in most of the economies under review. Loan euroization remains low in Romania and Bulgaria.











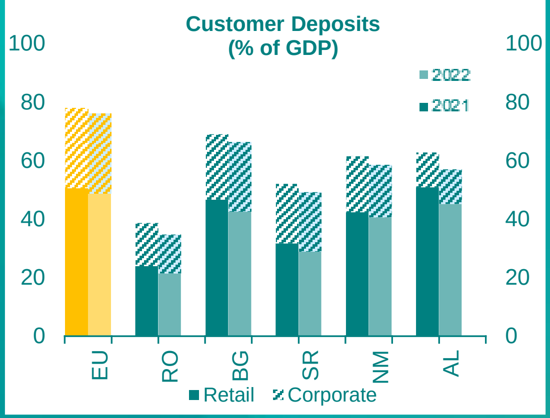
** Due to the distortive nature of the pandemic and authorities’ measures to mitigate its fallout, the year 2020 was excluded from the analysis/charts*

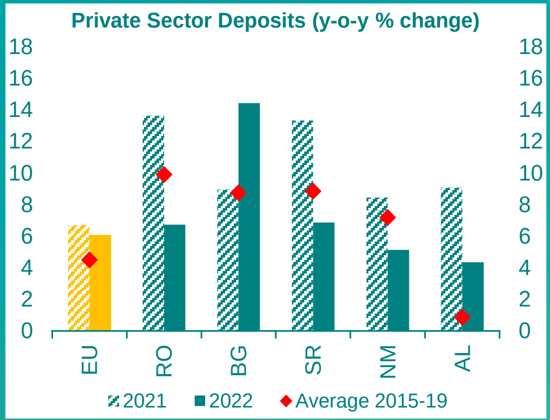
Sources: EBA, National Central Banks & NBG estimates

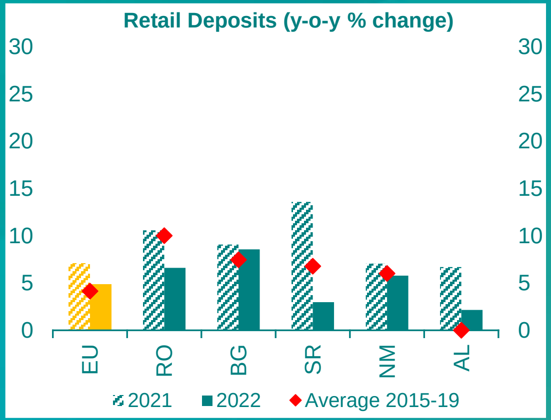
Banking Sector Activity - 2022 Overview

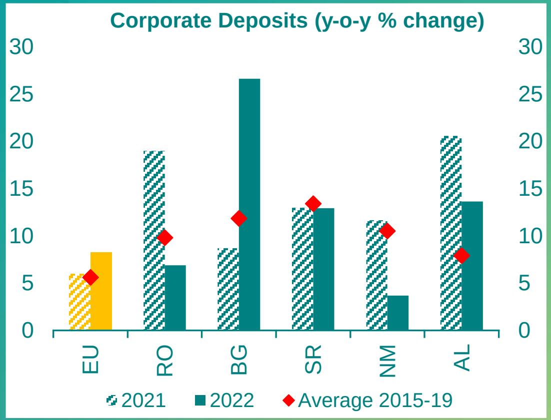
> … while deposit growth was strong

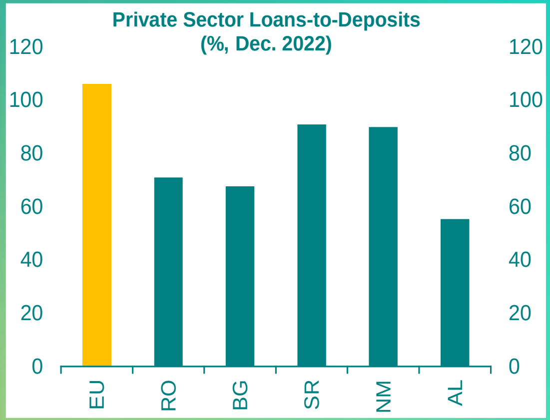
- ✓ Deposit growth in SEE-5 eased markedly in 2022, as, in light of rising lending rates and high inflation, firms and households became more prone to make use of their liquidity buffers. The full unwinding of COVID-19 emergency measures took also a toll. The only exception was Bulgaria, where the generous state energy subsidy scheme to businesses led to a boost in corporate deposits
- ✓ As a result, the deposit-to-GDP ratio eased, broadly returning to pre-COVID-19 levels
- ✓ The highest deposit levels as percent of GDP were seen in Bulgaria (66%, still below the EU average of 76%). In contrast, Romania remains the less penetrated market not only in the region but also in the EU
- ✓ Deposit growth lagged behind credit growth in all the economies under review, except Bulgaria. From a macro-perspective, this discrepancy was reflected in the rapid deterioration in external imbalances
- ✓ Consequently, after plunging during the pandemic, mainly due to “forced” savings accumulated, the loan-to-deposit ratio resumed its upward trend
- ✓ Importantly, SEE-5 banking systems remain liquid, with their loan-to-deposit ratio standing below the critical 100% threshold, especially in Albania (55%)











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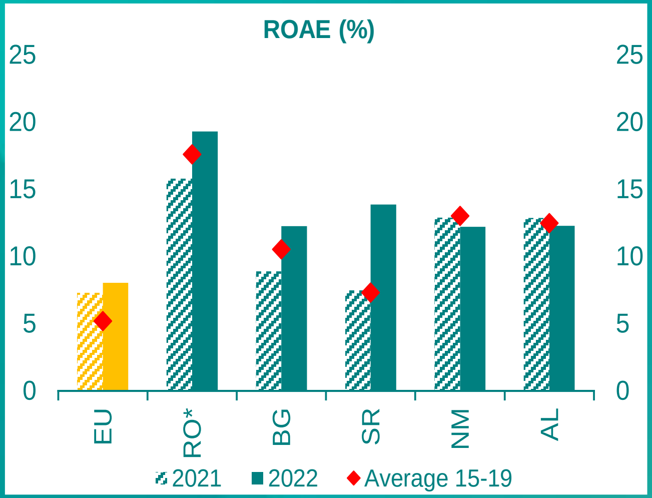
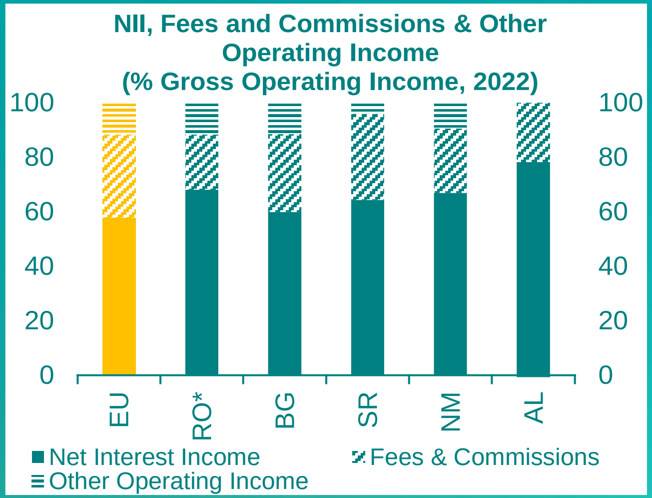
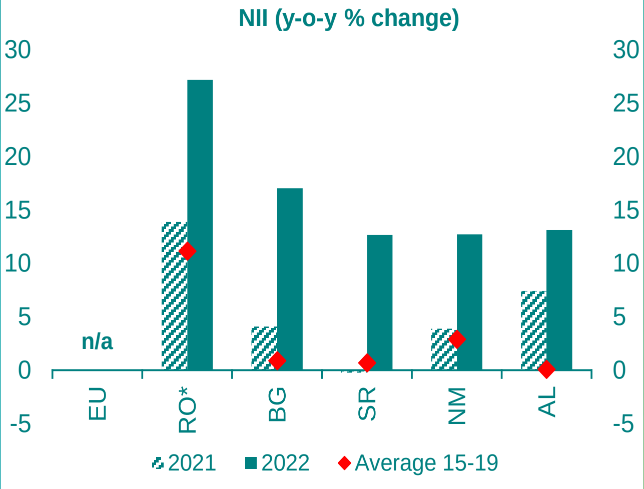
Banking Sector Profitability - 2022 Overview

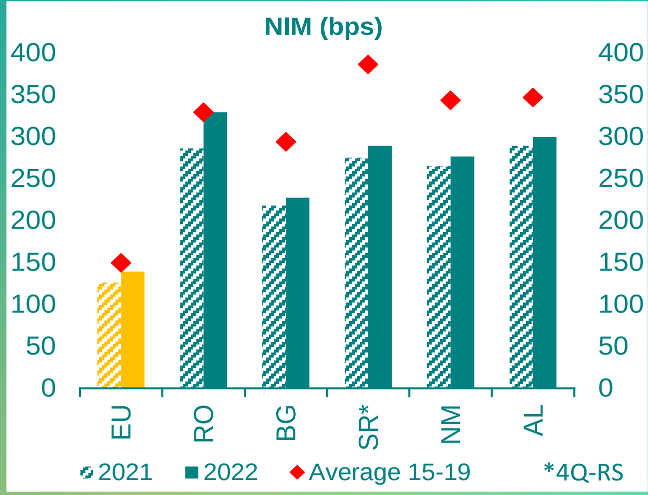
Profitability strengthened in 2022, driven by a rebound in NII

- ✓ Against the backdrop of rising interest rates and solid GDP growth, bank profitability rebounded in Romania, Bulgaria and Serbia in 2022, while remaining resilient in North Macedonia and Albania, with ROAE continuing to outperform EU standards
- ✓ Net interest income (NII), which accounts for the bulk of pre-provision income, surged in all the banking systems under review in 2022
- ✓ Unsurprisingly, SEE-5 banks' net interest margin (NIM) strengthened in 2022, in line with fast repricing not only of their (floating-rate dominated) loan portfolios but also of their large cash balances held with central banks. At the same time, their funding costs were adjusted sluggishly, reflecting banks' deposit-driven funding models and strong liquidity positions
- ✓ Romanian banks continued to enjoy the largest NIM (c. 330 bps), while Bulgarian banks the lowest (c. 230 bps), with the latter being c. $^{2}/_{3}$rds higher than that of EU banks
- ✓ Solid credit expansion, also underpinned by (full) resumption of deferred payments (under the expired COVID-19 debt moratoria), added to robust NII growth
- ✓ Net non-interest income (NNII, mainly fees & commissions) also picked-up in 2022, in line with solid economic growth
- ✓ The rupture between the EU & Russia and Ukraine's economic destruction had minimal direct consequences for the banking systems under review, given their insignificant exposure to Russia & Ukraine









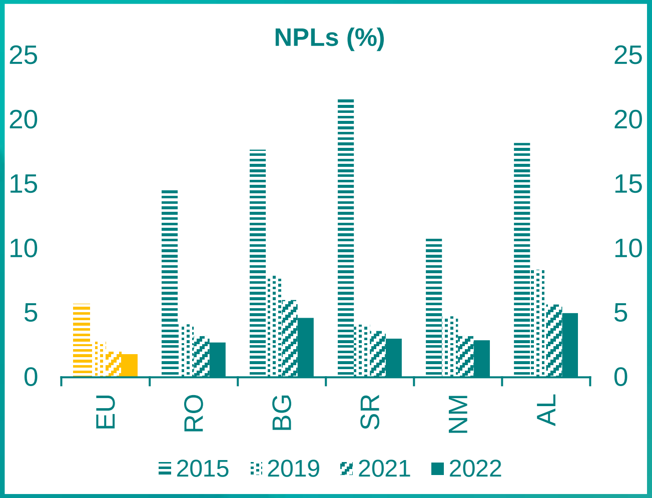
** 3 largest banks, together accounting for c. 43% of the banking system's assets*

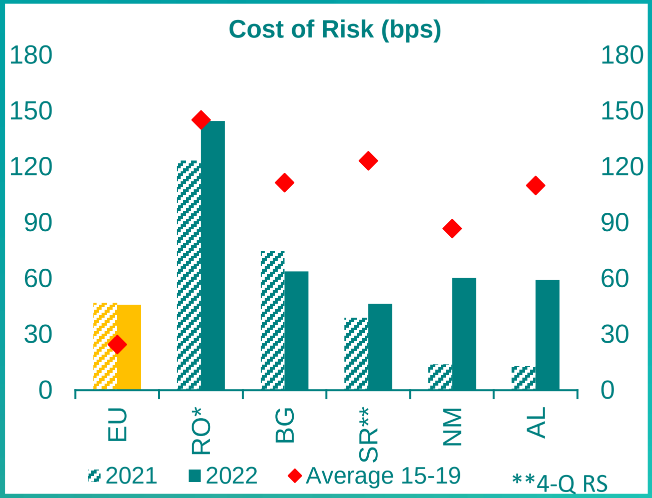
Sources: EBA, National Central Banks & NBG estimates

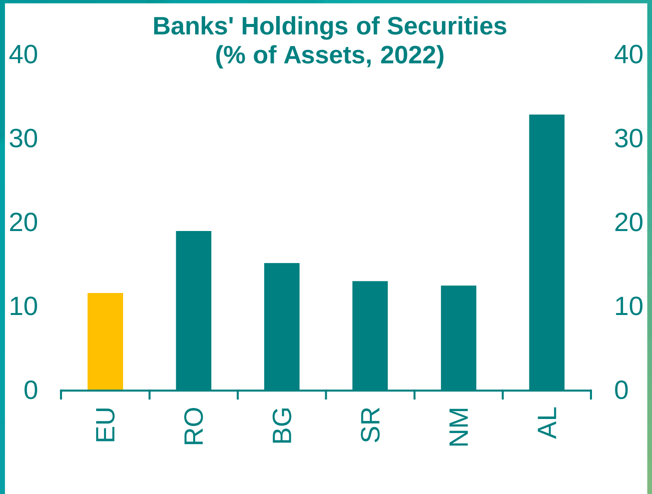
Banking Sector Profitability - 2022 Overview

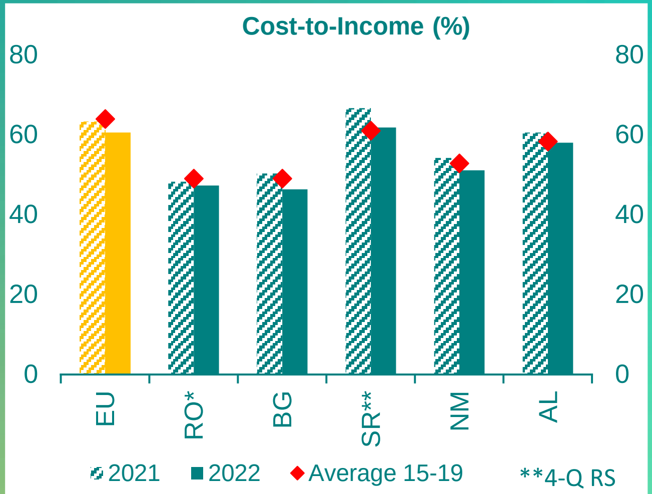
Looming asset quality concerns prompted SEE-5 banks to raise provisioning in 2022, despite lower NPLs

- ✓ In view of challenges lying ahead, most SEE-5 banks raised provisioning, albeit from a low base (with cost-of-risk remaining below pre-pandemic levels, following, *inter alia*, the clean-up of balance sheets), despite improved asset quality metrics
- ✓ Reflecting spillovers from economic recovery, on the one hand, and fast credit expansion, on the other hand, the non-performing loan (NPL) ratios in SEE-5 fell to multi-year lows in 2022. Nevertheless, they remain markedly above the EU average (1.8%), with Albania (5.0%) and Bulgaria (4.6%) topping the list
- ✓ Profitability would have been stronger had operating expenses not surged, mainly in line with the jump in inflation
- ✓ Despite their large security holdings, largely reflecting the deep sovereign-bank nexus (i.e. exposure to public debt, with Albanian banks topping the list, with security holdings equivalent to more than 30% of their assets, a share broadly equal to that of loans), SEE-5 banks wrote down limited unrealized losses from the plunge in bond valuations, as the bulk of their securities portfolios (with the respective shares ranging from 50% in Romania to 65% in Bulgaria and N. Macedonia) was measured at amortized cost
- ✓ Overall, SEE-5 banks' efficiency improved modestly in 2022, with their Cost-to-Income (C/I) ratios continuing to outperform the EU average (61.0%)









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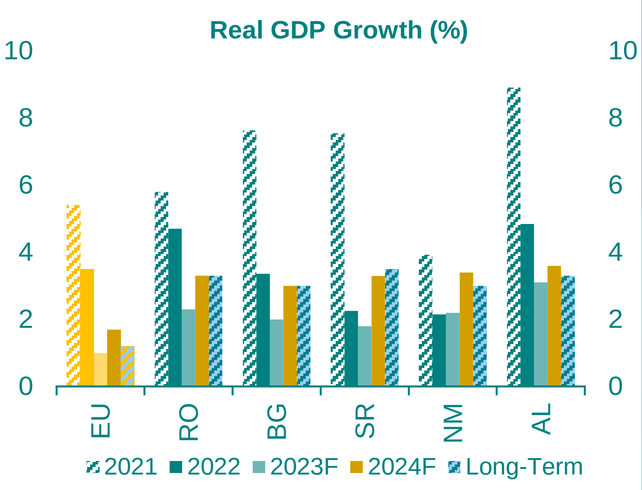
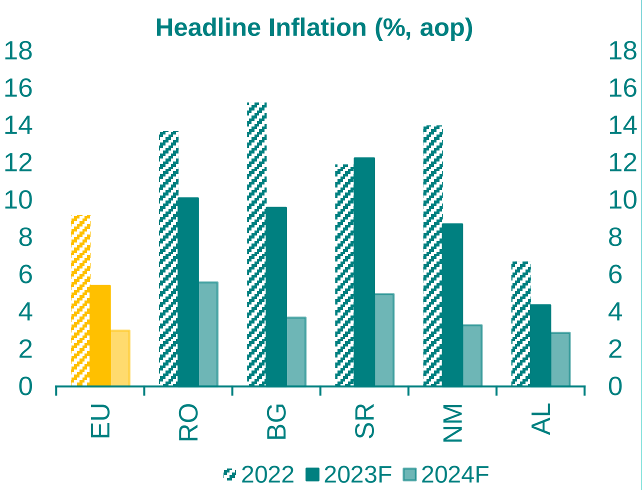
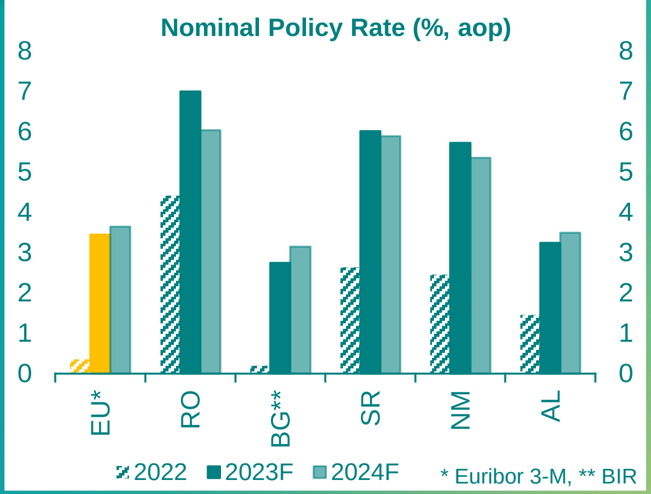
Macroeconomic Environment - Outlook

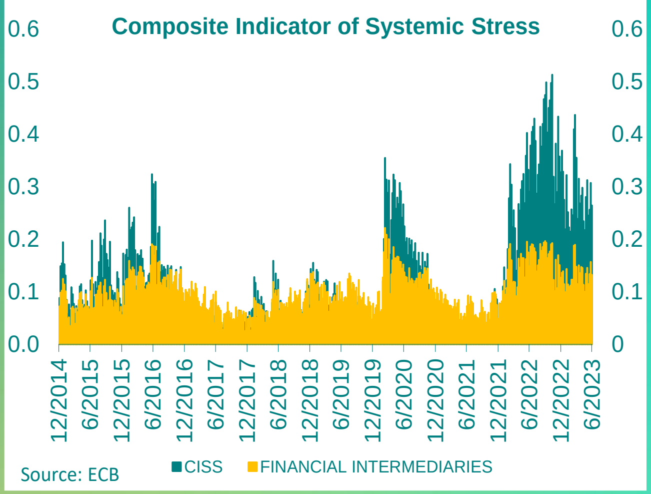
> *Against the backdrop of still high inflation, slowing -- but healthy -- economic growth and tightening financing conditions,…*

- ✓ Economic growth is set to ease markedly in 2023 in SEE-5, mainly due to the impact of still elevated inflation and tightening financing conditions. Public investment should provide a critical contribution to overall growth. Although it is set to soften, private consumption should remain resilient, thanks to still tight labour market conditions
- ✓ Inflation appears to have peaked in early-2023 and has now embarked on a downward path. Still, it is set to remain well above historical levels throughout the year
- ✓ Against this backdrop and in view of widened external imbalances and heightened uncertainty, central banks cannot but maintain their tightening bias, despite downside risks to economic growth and financial stability
- ✓ Soft economic growth and rising interest rates suggest a slowdown in the pace of fiscal consolidation this year, despite the gradual phasing-out of measures cushioning the impact of high inflation
- ✓ Assuming that inflation loosens its grip in 2024, allowing central banks to proceed with some modest rate cuts, we see GDP growth gaining steam, driven by private consumption and external demand
- ✓ Risks to the economic outlook are tilted to the downside, reflecting the lagging impact of monetary policy tightening, stickier-than-projected inflation and below-trend growth for the EU. Geopolitical tensions an escalation of the (non-systemic so far) crisis in the global banking industry could also weigh on the economic outlook
- ✓ Recall that the sudden failure of several mid-sized US banks and the loss of market confidence in Credit Suisse raised concerns about global financial stability in early-2023, highlighting the challenges from tighter financing conditions after a decade of ample liquidity. Note that the level of systemic stress remains elevated, yet below the levels seen at the beginning of the Russia-Ukraine conflict and during the pandemic
- ✓ Importantly, public debt levels remain low in SEE-5, minimizing the risk of contagion from banks to sovereigns







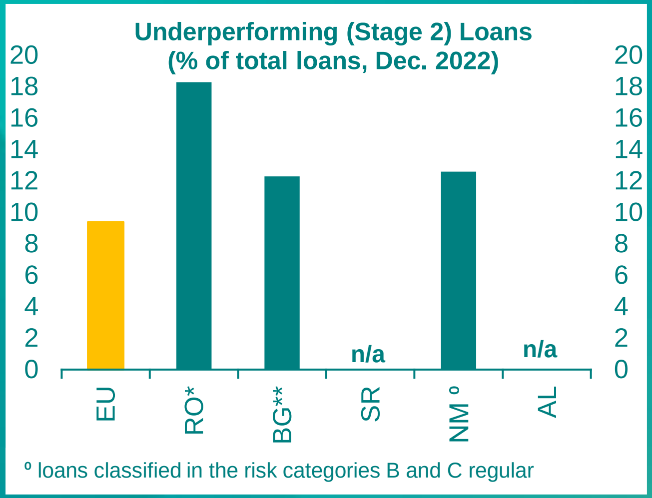


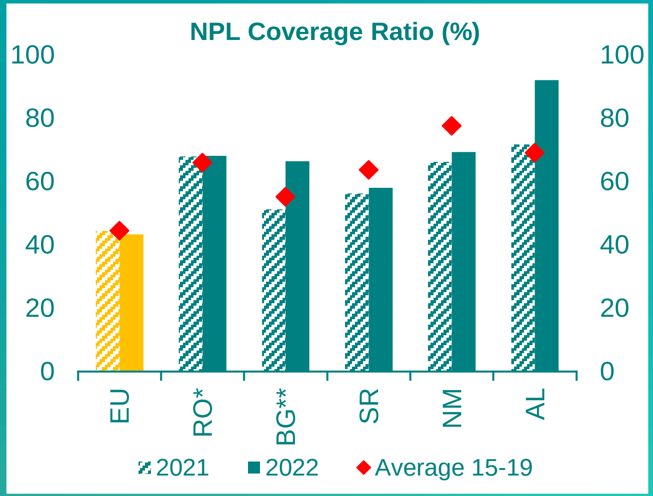
Sources: EBA, National Central Banks & NBG estimates

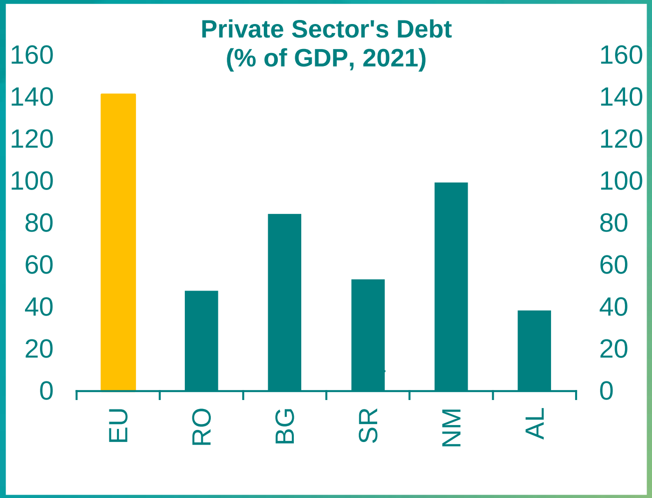
Banking Sector Profitability - Outlook

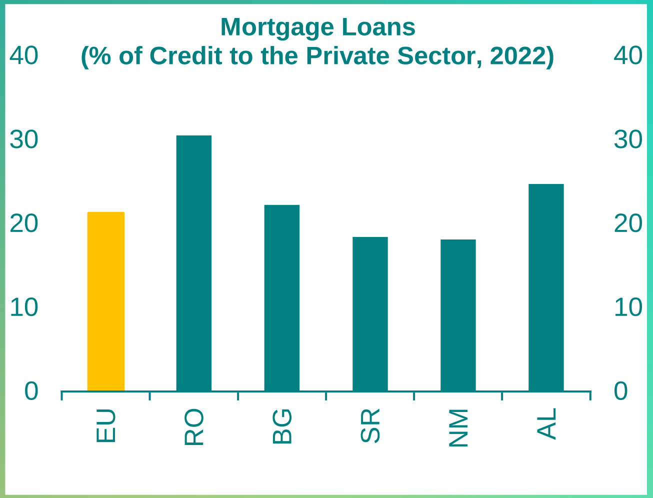
… SEE-5 banks' profitability should come under (modest) pressure, driven by higher provisioning needs…

- ✓ With elevated inflation and rising interest rates testing the private sector's debt repayment capacity, and in view of the already elevated ratio of underperforming loans (i.e. stage 2 loans), we expect SEE-5 banks to build up provisions at a faster -- yet still controlled -- pace in the period ahead
- ✓ On a positive note, past experience (ECB, Financial Stability Review, May '23) suggests that probabilities of default (PDs) are moderately affected when considering only the impact of higher interest rates. In fact, PDs increase much more when interest rates are accompanied with significantly higher unemployment and lower disposable incomes. For the time being, the latter scenario appears to be only a tail risk
- ✓ Challenges to the SEE-5 private sector's debt repayment capacity are also mitigated by its relatively low indebtedness
- ✓ Importantly, SEE-5 banks' elevated NPL coverage ratios -- ranging from 57% (Serbia) to more than 90% (Albania), exceeding markedly the EU average (43%) -- provide a buffer against a potential deterioration in asset quality
- ✓ Provisioning needs could increase further in the event of a disorderly property (collateral) price correction. On a positive note, according to estimates made before the turn of the financial cycle, real estate valuations were broadly fair in SEE-5, suggesting a more limited downside potential in the face of higher interest rates. In the SEE-5 sphere, Romanians banks are the most exposed to the real estate sector
- ✓ Similarly, provisioning (and/or capital) requirements could rise in the event of abrupt FX movements. The Albanian banking system is particularly susceptible to this risk, with c. 25% of total loans being unhedged









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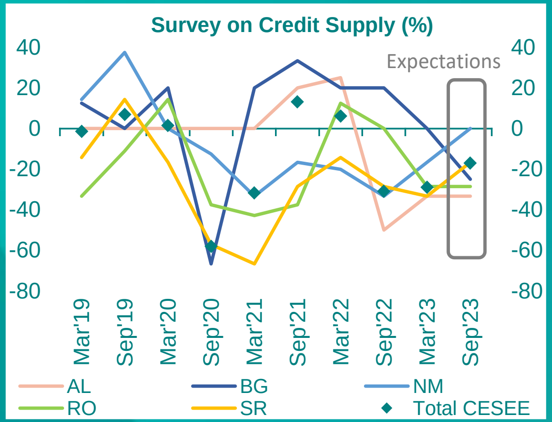
Sources: EBA, National Central Banks & NBG estimates

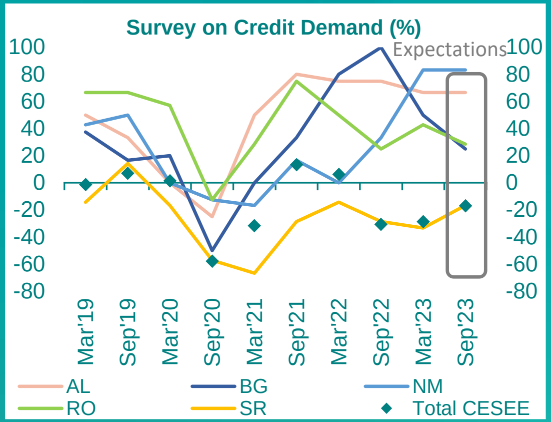
Banking Sector Profitability - Outlook

… and weaker NII growth

- ✓ NIM is also due to narrow in 2023, as funding costs catch up with lending rates, yet remain higher than the previous years
- ✓ At the same time, weaker loan origination should weigh further on NII growth
- ✓ Data from lending surveys point to a deceleration in credit expansion, with credit supply having been much more affected than credit demand, reflecting, *inter alia*, tightening lending standards and stringent macro-prudential policies (involving hikes in counter-cyclical capital buffers)
- ✓ The slowdown in credit expansion has been more pronounced in the corporate segment so far (albeit less so in Romania and Bulgaria, reflecting the sector's need to co-finance the investment projects included in the countries' RRF plans)
- ✓ Elevated inflation, together with the continuing digital transformation of the banking industry, mean that operating expenses are due to remain on upward trend in the period ahead. The ongoing streamlining of branches and staff optimization should help banks contain their operating expenses in the long-term



Source: EIB — CESEE Bank Lending Survey
Note: All values are net percentages.
Positive values denote increasing (easing) demand (supply)



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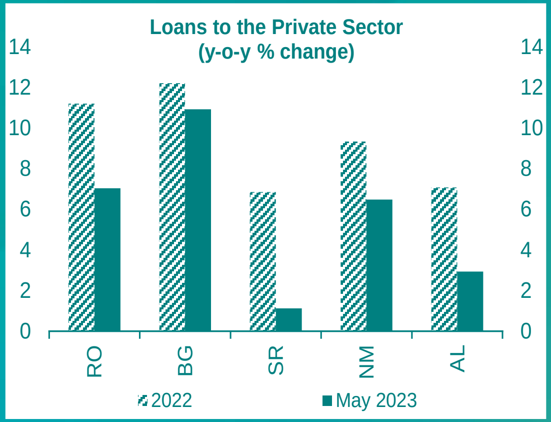

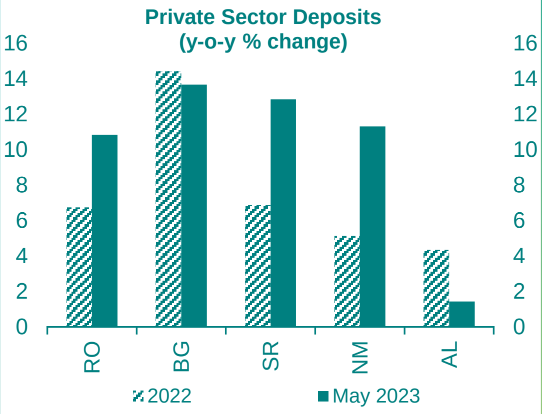

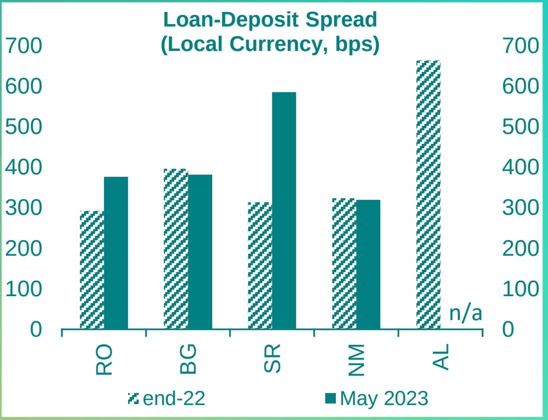

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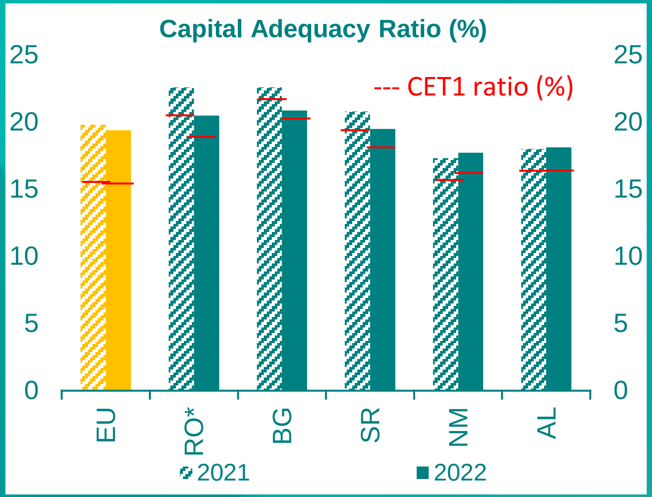
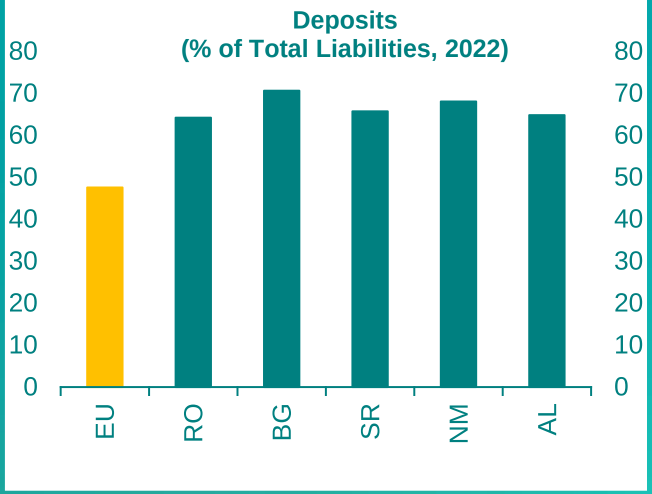
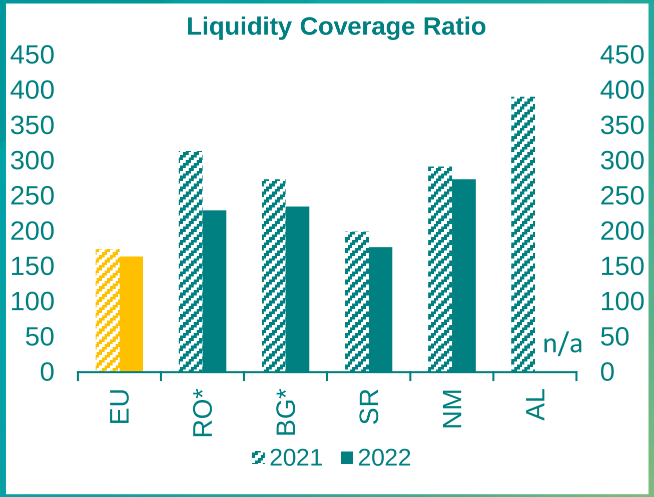
Banking Sector Profitability - Outlook

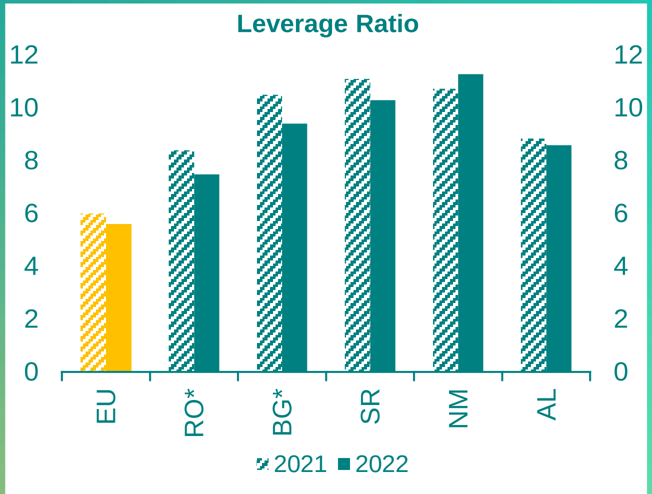
SEE-5 banks' strong fundamentals limit downside risks

- ✓ SEE-5 banks appear to be better placed than their EU peers to meet the challenges stemming from an environment of tight financing conditions, elevated inflation and relatively slow economic growth
- ✓ All banking systems under review are well-capitalised, with CET1 accounting for c. 90% of their total capital, suggesting that there is significant headroom -- which becomes even bigger when considering banks' solid profits -- to absorb potential losses
- ✓ At the same time, SEE-5 banks' liquidity positions remain strong, reflecting, *inter alia*, their large cash balances and holdings of Government paper, with the liquidity coverage ratio standing well above EU standards, ensuring their ability to withstand a period of stressed conditions without resorting to disorderly asset liquidation, thus incurring significant losses
- ✓ Importantly, SEE-5 banks' large and stable deposit base limits funding risks, as reflected in (still) widened bank credit spreads
- ✓ Note that the overwhelming majority of deposits in SEE-5 fall below the respective insurance thresholds, reducing banks' vulnerability to a confidence crisis









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General Information

Banking Underpenetration in SEE-5

✓ Several factors explain the stylized fact of positive correlation between the degree of financial intermediation and the countries' income in the SEE-5 region:

i. Banks increased exposure to the sovereign crowds out the private sector.. In Romania and Albania, loans to the public sector and banks' holdings of government securities account for a significant share of the systems' assets;

ii. The presence of many micro-businesses & SMEs, which are non-bankable, either due to weak fundamentals (e.g. in Romania, c. $^{1}/_{3}$rd of businesses had negative capital prior to the pandemic -- EBRD, Jan. 2020) or lack of credit history and information asymmetries;

iii. The large size of grey economy, which keeps market liquidity out of the banking system. The shares of grey economic activities in SEE-5 range from 24% of official GDP (Romania) to 34% (North Macedonia), well above the EU average of 19%;

iv. The relatively high concentration of the banking sector, which may enable banks to curtail credit supply, while reaping excess profits

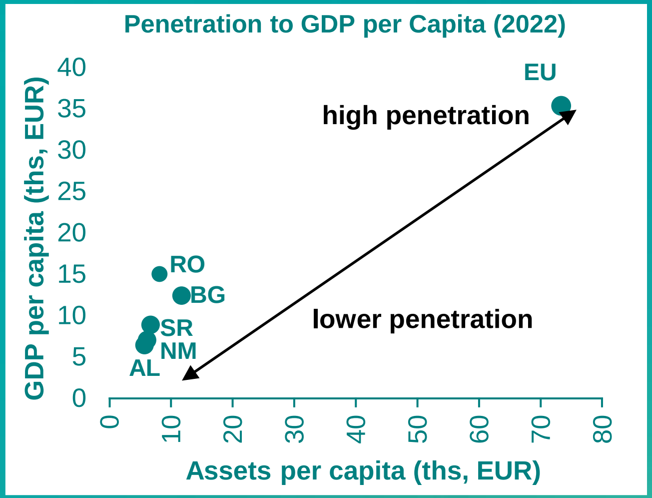
v. The sector's still significant stock of legacy NPLs. Despite having been drastically reduced over the past years, the NPL ratio in SEE-5 still exceeds the EU average, continuing to burden banks' balance sheets, while making them more cautious as to new lending;

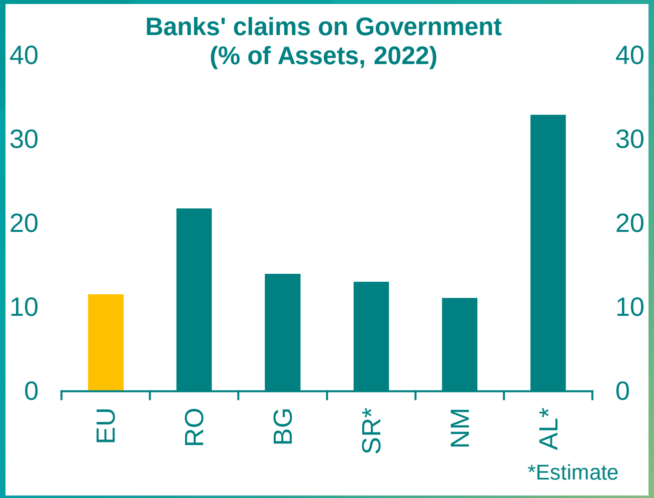
vi. The relatively poor quality and soundness of legal & regulatory frameworks, including weak bankruptcy and insolvency regimes

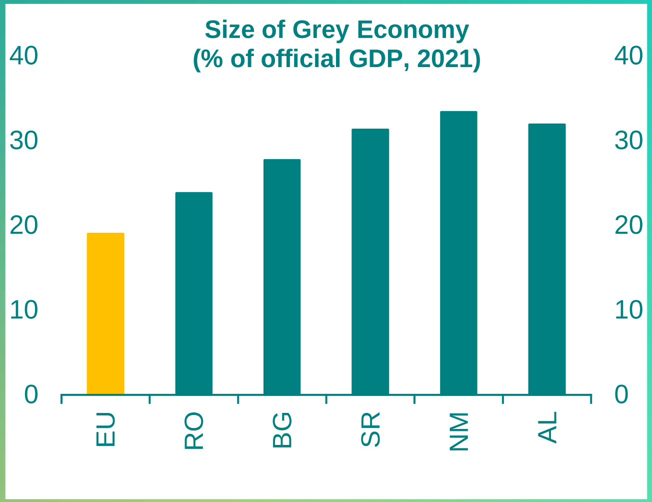
vii. Low levels of trust in banks & low financial literacy rates, especially in countries that suffered in the past by banking crises and Ponzi schemes (e.g. Albania)

Note that the gap in terms of assets per capita between SEE-5 and EU banks is amplified by the formers' limited non-lending activities (mainly confined in holding cash and Government securities)

> *Banking penetration in SEE-5 is low, in line with the region's lagging income*







Sources: EBA, EBRD National Central Banks, World Economics & NBG estimates

2022 Overview

Macroeconomic Environment

Banking Sector Activity

Profitability

Outlook

Macroeconomic Environment

Banking Sector Profitability

Banking Underpenetration in SEE-5

General Information

General Information

- ✓ Strong foreign (mostly EU) presence in SEE-5, which has enhanced regional banks’ access to credit, while contributing, *inter alia*, to the migration of modern banking practices
- ✓ M&A activity continued in 2022 in SEE-5 (Romania: 1 merger and 1 bank closure, Bulgaria: 1 bank acquisition, Serbia: 2 mergers and 1 bank acquisition, Albania: 1 merger)
- ✓ Market concentration appears to be low-to-moderate in Romania, Bulgaria and Serbia, suggesting that there is scope for further consolidation in these systems, with smaller and less-efficient banks being potential acquisition targets for regional and/or local players seeking synergies
- ✓ Rapidly advancing digitalization and continuing consolidation across the SEE-5 banking sectors have been driving the decline in the number of employees and branches over the past few years. This trend is expected to continue in the medium-term

	 Romania	 Bulgaria	 Serbia	 North Macedonia	 Albania
Population (2022, mn)	19.0	6.8	6.8	1.8	2.8
GDP (2022, EUR, bn)	286.6	84.6	60.4	12.9	18.0
GDP per Capita (2022, EUR)	15,053	12,439	8,901	7,061	6,443
S&P / Moody’s / Fitch	BBB- / Baa3 / BBB-	BBB / Baa1 / BBB	BB+ / Ba2 / BB+	BB- / NR / BB+	B+ / B1 / NR

Banking Sector Indicators (2022)					
	Romania (RO)	Bulgaria (BG)	Serbia (SR)	North Macedonia (NM)	Albania (AL)
Ownership: Number of Banks					
Number of Banks	32 [a]	25	21	13	11
Foreign Owned	25	16	17	7	7
State Owned	3	2	2	1	0
Ownership: Share in Assets (%)					
Foreign Owned	68.1%	78.1%	83.6%	67.2%	68.6% [e]
State Owned	12.2%	3.4%	7.0%	2. 4%	0.0%
Concentration: 5 Largest Banks’ Market Share (%)					
Assets	56.0% [b]	67.2%	59.7%	81.5%	76.8%
Branch Network & Number of Employees					
Branches	3,522	4,526	1,371	382 [d]	396
Number of Employees	51,857	25,956	21,995	5,830 [d]	6,737
Intermediation (% of GDP)					
Assets	54.0 [c]	94.0	74.8	86.1	88.0
o/w Credit to Private Sector	24.6 [c]	44.9	44.7	52.7	31.6
Deposits	34.7 [c]	66.4	49.2	58.6	57.0

a: excluding cooperative banks (40), b: 2020, c: 3 largest banks, together accounting for c. 43% of the banking system’s assets, d: 2020, e:2021

Sources: EBA, National Central Banks & NBG estimates

General Information

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Liquidity					
Liquidity Coverage Ratio (%)	229.8	235.0	177.5	273.8	391.0 [e]
Asset Quality					
NPLs (%)	2.7 [c]	4.6	3.0	2.9	5.0
NPL Coverage (%)	68.2 [c]	66.5	58.1	69.4	92.2
Efficiency					
Cost / Income (%)	47.0 [c]	46.0	61.8	51.2	58.0
Leverage & Capital Adequacy					
Leverage Ratio (Tier 1)	7.5 [c]	9.4	10.3	11.3	8.6
Tier 1 Capital Ratio (%)	17.2 [c]	20.0	18.8	16.5	16.9
CAD (%)	20.5 [c]	20.9	19.5	17.7	18.1
Profitability					
NIM (bps)	329 [c]	227	289	277	300
ROAE (%)	19.3 [c]	12.3	13.9	12.2	12.3
ROAA (%)	1.5 [c]	1.3	1.9	1.5	1.4

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Sources: EBA, National Central Banks & NBG estimates

Disclosures

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