Reports

Management summary[1]

Financing conditions tighten in line with monetary policy

While the European economy has proved resilient to the initial effects of the war in Ukraine, persistent inflation, the effects of monetary tightening and high geopolitical uncertainties now weigh on the outlook. Since mid-2022, economic growth in Austria has decelerated and companies and households are confronted with tighter financing conditions. Uncertainty about economic developments has been dampening companies' demand for loans, as they are more cautious about investments. Given that most loans to the corporate sector are variable rate loans, companies' debt-servicing costs are rising significantly. However, due to a marked increase in companies' profits in 2022, their debt-to-income ratio went down last year, sinking below historic levels by year-end. Still, high input costs, tightening financial conditions and the clouded economic outlook, which have increased potential credit risks, are particularly challenging for more vulnerable firms. Amid rapidly rising interest rates and banks' tightening supply policies, the growth of bank lending to Austrian households has been decelerating since mid-2022. Apart from housing loans, where lending growth slowed down most strongly, consumption and other loans have also exhibited declining growth rates. Dynamics in Austria's residential real estate market have likewise been slowing. Credit default rates still remain low. To preserve this, binding borrower-based measures are key to ensuring sustainable lending practices.

Austrian banks benefited from rising interest rates

In 2022, the Austrian banking sector profited from rising interest rates, as banks passed them on to both new borrowers and borrowers with variable rate loans, while deposit repricing was still slow. Given that fees and commissions also grew markedly, credit quality remained good and profits from Russia were exceptionally high, the Austrian banking sector reported a record profit of more than EUR 10 billion. Half of it came from subsidiaries in Central, Eastern and Southeastern Europe (CESEE). The recent turmoil following bank failures in the United States and Switzerland had rather small (and only indirect) effects on the Austrian banking sector, whose exposure to debt securities is relatively limited and whose liquidity position is solid. Furthermore, the sector's capitalization has improved, mirrored in a CET1 ratio above 16%. It is noteworthy, however, that the largest banks' capital ratios trail behind those of their smaller competitors. Macroprudential supervisors in Austria decided at the end of 2022 to phase in further structural capital buffer requirements until 2024. These efforts support favorable external assessments, as confirmed by a rating by S&P Global Ratings that ranks the Austrian banking industry among the most stable worldwide.

Lending for residential real estate (RRE) is marked by a fragile environment, with prices having doubled in Austria over the past ten years and interest rates starting to rise rapidly in 2022. These developments are reducing the affordability of RRE and related loans. In the fourth quarter of 2022, the OeNB RRE price index declined for the first time in many years and dropped further at the beginning of 2023. Moreover, new lending volumes decreased substantially amid rapidly

[1] *For a German-language management summary of the Financial Stability Report 45, see Finanzmarktstabilitätsbericht - Oesterreichische Nationalbank (OeNB).*

increasing interest rates. A sizeable portion of new mortgages continued to be offered at unsustainable debt service-to-income and loan-to-value ratios before compliance with borrower-based measures was made mandatory. Also, the previous trend of increased fixed rate borrowing reversed in 2022, with half of new RRE lending being granted at variable rates again. These developments underline the importance of sustainable lending standards. Last year, borrower-based instruments became binding to maintain a high-quality loan portfolio and address potential systemic risks from RRE financing. As of August 2022, Austrian banks must adhere to a legally binding regulation when granting RRE loans. The provisions include upper limits for loan-to-value ratios (90%), debt service-to-income ratios (40%) and loan maturities (35 years). Plus, according to a recent amendment, bridge loans are excluded and the de minimis threshold for housing loans to couples has been raised. Lending standards have improved markedly as a consequence. Finally, commercial real estate (CRE) lending also warrants increased scrutiny, as headwinds are arising from higher interest rate levels as well as structural shifts, such as the increasing importance of environmental building criteria, online shopping and remote work.

Recommendations by the OeNB

Past efforts by Austrian banks and forward-looking prudential measures to raise banks' risk-bearing capacity have paid off. In the years following the global financial crisis, Austrian banks have significantly improved their capital ratios and funding structures. In 2022, their profits reached record levels, while credit risks stood at historic lows. Persistent inflationary pressures and the consequences of monetary policy tightening as well as the war in Ukraine now pose substantial challenges for the Austrian banking sector, however. The situation might deteriorate if the benign effects of higher interest rates faded, credit risk costs rose or operations in Russia ceased to be an important profit driver. Given today's uncertain macrofinancial and geopolitical conditions, the OeNB recommends that banks further strengthen financial stability by taking the following measures:

- Strengthen the capital base by exercising restraint regarding profit distributions.
- Adhere to sustainable lending standards for residential 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 and interest rates.
- Continue efforts to improve cost efficiency to ensure structurally strong profitability.
- Further develop and implement strategies to deal with the challenges of new information technologies, increased cyber risks and climate change.