City exploits its position at the crossroads

The Austrian capital is well placed to take advantage of the growth differentials between eastern and western Europe, says Neil Buckley

Sit in one of Vienna's famed cafés and you may hear Slovak at the next table, Hungarian at another and Russian at a third. It may no longer be the imperial capital to which its imposing palaces and boulevards remain monuments, yet, once again, the city is a crossroads between east and west.

For decades after the Austro-Hungarian empire collapsed in 1918, Vienna found itself marginalised. Since 1989, however, and at an accelerating pace over the past decade, the city has again become a gateway to central and eastern Europe.

For much of the past decade that was an advantage – exposure to Europe's fast-growing eastern half helped Austria's economy expand faster than the eurozone average. Then, early last year, it suddenly seemed to have become a liability.

The former communist bloc was the area hit hardest by the global financial crisis, with fears of a regional meltdown similar to the Asian crisis of the late 1990s.

The heavy exposure of Vienna's businesses, and of the broader Austrian economy, to the region beyond seemed to imperil their prospects, too.

Today, there is a sense that the worst is past, and the crisis was not as deep as feared – even if the debt troubles of the eurozone periphery leave lingering concerns.

Thomas Wieser, a senior official at the Austrian finance ministry, suggests that overall growth rates across the continent will be lower in coming years than before the crisis. But provided Germany and France, the European "core" that is the main export market for central and eastern Europe, continue to grow, then the region will enjoy superior growth.

"If that growth differential remains," adds Mr Wieser, "then I would say Vienna will stay ahead of the game, as it has over the past 10 years."

Austria's banks, above all, led the eastwards advance, through groups such as Bank Austria, now owned by Italy's UniCredit, Erste Group and Raiffeisen International. The central and eastern Europe region now provides the bulk of their profits and growth prospects. Andreas Treichl, chief executive of Erste Group, notes that Austria's banks focused mainly on retail banking, bringing modern financial services to citizens long deprived of them, rather than diversifying into more esoteric areas of finance. That helped them when economies turned bad last year.

Historic city looks to its future: the Austrian capital's cosmopolitan nature helps it in dealings with eastern neighbours Dreamstime

"One of the nice things about retail banking is that it doesn't necessarily depend so much on the economic performance of the country, as long as the country doesn't go bust," he says.

But the banks were not alone. In insurance, real estate, construction, Austrian companies moved to take advantage of the growth prospects to the east and south-east. They were among the first to expand into the region after the fall of communism, to their advantage.

Many international companies chose to run their central and eastern Europe operations from Vienna. Legal, accounting and consultancy firms expanded to meet the demand.

Vienna's stock exchange became one of Europe's best performers, tripling in value between 2003 and 2007. It also bought up regional bourses, though its market capitalisation remains tiny by comparison with better known rivals.

Vienna drew on many in-built advantages. For five years running, it has been ranked the world's most "liveable" city by Mercer Consulting – citing its political stability, and excellent transport links, culture and leisure facilities.

"Vienna is one of the very few cities in the world with infrastructure for more inhabitants than it currently has," says Holger Schmidtmayr, the board member at Vienna-based property group Sparkassen Immobilien responsible for its CEE portfolio. "It was built for 2m in the early 20th century, and now it has about 1.6m."

> 'Vienna is one of the very few cities in the world with infrastructure for more inhabitants than it currently has'

The Austrian capital is less than three hours by train from Budapest, an hour by car from Bratislava, and a short hop from Warsaw, Prague, Bucharest and Belgrade.

"Two times a year I have a private jet, and the rest I can do in a day from Vienna," says Herbert Stepic, chief executive of Raiffeisen.

Mr Stepic points to his own Croatian surname as evidence that he, like many in the city, has immigrant roots ("I'm a multi-culti guy," he quips). That cosmopolitanism helps the Viennese in dealing with eastern neighbours.

Also like many in the city, Mr Stepic suggests the worst fears about last year's crisis were exaggerated. Media and analysts, they say, often failed to differentiate between CEE countries' varying prospects.

In the end, performances varied from double-digit economic contractions in Ukraine and the Baltic republics of Latvia, Lithuania and Estonia, to continued growth, of 1.7 per cent, in Poland.

There were no sovereign defaults in the region, and a systemic banking crisis was avoided. The likes of Erste and Raiffeisen continued to make profits, though non-performing loans rose sharply, and Hypo Group Alpe Adria, Austria's sixth-largest bank, had to be nationalised.

One reason a broader crisis was averted was thanks to financial support from institutions such as the International Monetary Fund.

Austria's government and financial community was at the centre of efforts to rally such support, as reflected in the title of the so-called "Vienna Initiative", a multilateral programme designed to ensure western banks did not pull out of the CEE region.

Just like their performance last year, CEE countries' recovery is likely to be multi-speed. That could cause problems for Austrian companies, which are often more strongly exposed to the weaker performers.

The crisis also exposed some weaknesses of Vienna as a financial centre. Though Austria's banks focused on retail banking and financing, not toxic assets, non-performing loans still threatened for a while to become a serious problem. Many banks lent in euros or Swiss francs – a boon for consumers who benefited from lower interest rates, until sharp depreciations of many CEE currencies last year made it look less wise.

Bodies such as the European Bank for Reconstruction and Development now aim to build up local currency lending and capital markets in CEE countries. Austria's banks may have a role to play in that – but it could diminish Vienna's financial clout.

Austria's ruling coalition also recently announced it had agreed on a bank solidarity tax that would come into force next year. Vienna is hardly alone in proposing a bank tax, and its version is less severe than proposals in neighbouring Hungary. Yet such measures, and a sense among many Viennese that the government is not sufficiently business-friendly, could add to high income tax rates in being a disincentive to investment.

Yet Mr Wieser believes Vienna will continue to benefit from its position. Partly thanks to early exposure to competition from low-income neighbours after 1989, which led to jobs leeching across its borders, Austria learned faster to deal with globalisation than countries further west. That gave it an enduring advantage.

"We have not been clever," he says; "we have been extremely lucky."

Old stager has yet to make a comeback

Stock market

Low volumes are hitting Vienna's regional role, write Chris Bryant and Jan Cienski

Although 2010 marked the return of relative calm, Vienna's stock exchange has so far derived only limited benefit.

The Wiener Börse, whose foundation in 1771 enables it to boast one of the longest track records in the business, has not yet recaptured the spark that generated several years of stellar growth in the years preceding the crisis.

Compared with the depths of 2008, of course, much has improved. After hitting a low in March 2009, the ATX index of leading shares staged a breakneck rally.

Investors took the view that anxiety over Austrian banks and real estate firms' operations in central and eastern Europe had been overdone, helping total market capitalisation recover from €53.1bn ($66.75bn) at the end of 2008 to €77.5bn in December.

But the recovery has not continued in the first half of this year. Although good corporate results sustained an early rally, worries about the impact of the sovereign debt crisis, as well as fears of contagion in emerging Europe, punched a hole in this nascent confidence.

The ATX is down slightly this year, while average monthly equity turnover was €7bn for the period January to May – a modest improvement on the 2009 average of €6.2bn, but far below the previous year's average of €11.7bn.

Investor anxiety has been matched by that of the corporate sector, leading to a dearth of initial public offerings; the last was the €1.3bn listing of Strabag, a construction company, in 2007.

Although 2009 was a bumper year for capital-raising, including €1.74bn by Erste bank, this year's total is just €51m.

However, Vienna is likely to benefit from the plans of Verbund, an electrical utility, to raise €1bn before the end of the year.

The modest report card shows little sign of unsettling Heinrich Schaller, one of the exchange's two chief executives.

"The volumes have improved, but are still not where we'd like them to be," he explains over the distant sound of workmen refurbishing the building.

"The turbulences as a result of concerns about state liabilities have unsettled the markets. It's not easy to predict whether, for new issuers, this trust will come back quickly."

The drought is especially painful because it risks hampering Vienna's fierce competition for regional pre-eminence with the Warsaw Stock Exchange.

Vienna stole a march on its Polish rival in the race to acquire regional bourses. Since 2004, it has picked up majority stakes in the Prague, Budapest and Ljubljana exchanges and last year brought these together under the umbrella of the CEE Stock Exchange Group.

"We want to create a unified market with regard to trading rules for investors in this region. And this will make it much easier for investors and new issuers to operate," Mr Schaller explains.

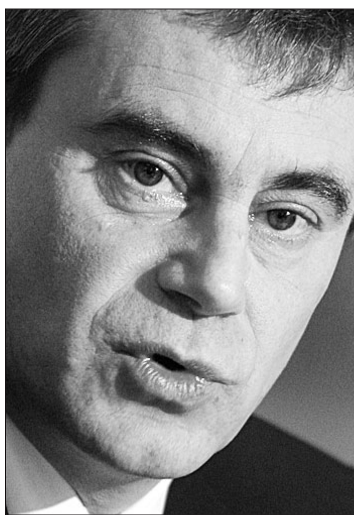
Amid a similar lack of new listings in the region, the most pressing task for CEESEG is one of consolidation. Deutsche Börse's Xetra system and a uniform data feed are being rolled out across all four exchanges.

The hope is that this will boost liquidity by making it easier for foreign investment firms – which already form a majority of trading participants – to access these markets.

However, in the meantime Warsaw has attracted a slew of new issuers – including the 6bn zloty ($1.84bn) IPO last year of PGE, Poland's largest power generator.

Vienna's attempts to forge a strategic partnership with the state-owned bourse were rebuffed last year, with Warsaw now due for privatisation before the end of 2010.

Mr Schaller rejects the suggestion that Vienna is falling behind, noting that Warsaw is benefiting from the performance of the Polish economy – the only one in the European Union to grow last year.



Schaller: transaction tax warning

If the four exchanges are taken together, CEESEG still enjoys the edge over Warsaw in terms of market capitalisation and average monthly turnover.

But some analysts say Warsaw's challenge cannot be dismissed so easily. "Although you might have a great system, if you don't have the clients, then it's going to be very tough," says Maurizio Bradlaw, partner at Capco, the financial services consultants.

Warsaw's pull could become even stronger if Austria were unilaterally to introduce a financial transaction tax, as proposed by Werner Faymann, the Social Democratic Austrian chancellor.

"We think that is extremely dangerous, because the market, capital and trade of financial products would to a large extent, very quickly move abroad," warns Mr Schaller.

Perhaps with these threats in mind, Vienna has developed a range of new index products and services, and in December began operating a new gas exchange (*see separate story*).

It also continues to look for acquisitions, with bourses in Bucharest, Zagreb, Sofia and Sarajevo all considered attractive.

"The interest is still there," Mr Schaller says, "but at the moment we're not holding concrete talks."

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Alternative investments A small but lively industry

Austrians are known for their conservativism in saving and investing – fewer than a 10th of the population own shares. Yet the country is home to a small but lively alternative investment industry that has done well even in the financial crisis.

Hedge funds and closed-end funds in Austria have €7bn-€8bn under management, says Martin Greil, general secretary of the Association for Alternative Investments. Relative to population and the size of the financial market, the alternative investment industry is far stronger in Austria than in neighbouring Germany, where hedge funds never really got off the ground.

"Austria has been in the forefront of alternative investments for a long time," Mr Greil says. "Now, we have a small but distinguished selection of local niche players and a variety of foreign asset managers who regard Vienna as a good location for moving into eastern Europe."

The base for the industry was laid by lawmakers who tried to accommodate the needs of the industry, says Stefan Pichler, a banking expert at the Vienna Business School. "Austria has a very good legal framework for investment funds that makes a clear distinction between funds catering to the general public and those that do not. There are strict transparency rules with daily reporting requirements for hedge funds, but otherwise there is a lot of flexibility. The Austrian laws go to the limit of what is permitted under EU regulation."

The first hedge fund launched in Vienna, 10 years ago, was Hasenbichler Asset Management, which specialised in managed futures and commodities trading and advisory. "Nobody did this kind of business in Europe at the time", says Bernd Hasenbichler, fund owner and manager.

His story also illustrates the difficulties of doing business in Austria.

In 1996 he moved to the Bahamas, and in 2002 he transferred his whole business there when a change in Austrian tax laws made large parts of his business unprofitable. Today, he has only €50m under management.

He still runs a small research unit in Vienna and sells his funds through the banks. But once the Alternative Investment Fund Manager (AIFM) directive of the European Union goes into effect, he would consider setting up an independent sales force again.

The most visible hedge-fund company in Vienna is Superfund, launched in 1996 by Christian Baha, a former police officer, and Christian Halper, an engineer who developed computer-trading software that makes the investment decisions. With Mr Baha as the public face, Superfund used aggressive advertising and marketing to sell to inexperienced retail investors in Austria and 20 other countries.

Excellent returns until 2003 helped the fund grow, but Superfund fell back during the 2004-2007 boom years and has struggled since.

Other funds sell mostly to institutional investors and specialise in structured products and closed-end funds. A boom in shipping funds ended a few years ago, giving way to a variety of technology funds specialising in renewable energy projects, Mr Greil says.

The industry is nervously awaiting the AIFM rules, better known as the hedge fund directive, but the intensive negotiations between the European Commission, Parliament and member states will not be finalised before September.

The directive will cover all funds that do not fall under the directive on Undertakings for Collective Investments in Transferable Securities (Ucits), which applies mainly to consumer-oriented funds.

Some 38 per cent of assets under management in Austria are held in non-Ucits funds and would be affected by the AIFM directive. That compares with 25 per cent across the EU and 15 per cent in the UK, says Deloitte, the financial consultancy.

Some Austrian fund managers are sharply critical of the fact that the AIFM directive will also apply to funds that are specifically set up to manage assets of single institutional investors, a category that is particularly popular in Austria. These funds are not publicly traded and are mostly designed for large pension funds, insurance companies and industrial groups.

"There is no good reason for a hedge fund directive to apply to funds that are of a completely different nature," says Heinz Macher, head of the legal department of Raiffeisen Capital Management, a fund company.

The company will also require double-licensing procedures under the Ucits and AIFM directives and will face divergent rules for different parts of its business.

Eric Frey

Christian Baha of Superfund, a hedge fund Bloomberg