

7th Capital Markets Day –

4 October 2010, Dubrovnik, Croatia

Taking stock after 20 years of transformation –

Hungary: Former front-runner recovering on a new track

Edit Papp, CEO, Erste Bank Hungary

– Long-term economic development patterns

- Economic and political timeline
- Economic scorecard: real economy, fiscal performance & monetary policy
- Social indicator scorecard: backing up economic progress
- Focus topic: charting the development of residential real estate

– Evolution of the banking market

- The emergence of retail banking
 - Moving away from the cash economy
 - The loan growth story
 - Wealth creation: from deposits to fund management
- The transformation of corporate banking
 - From financing the state sector to financing private enterprise

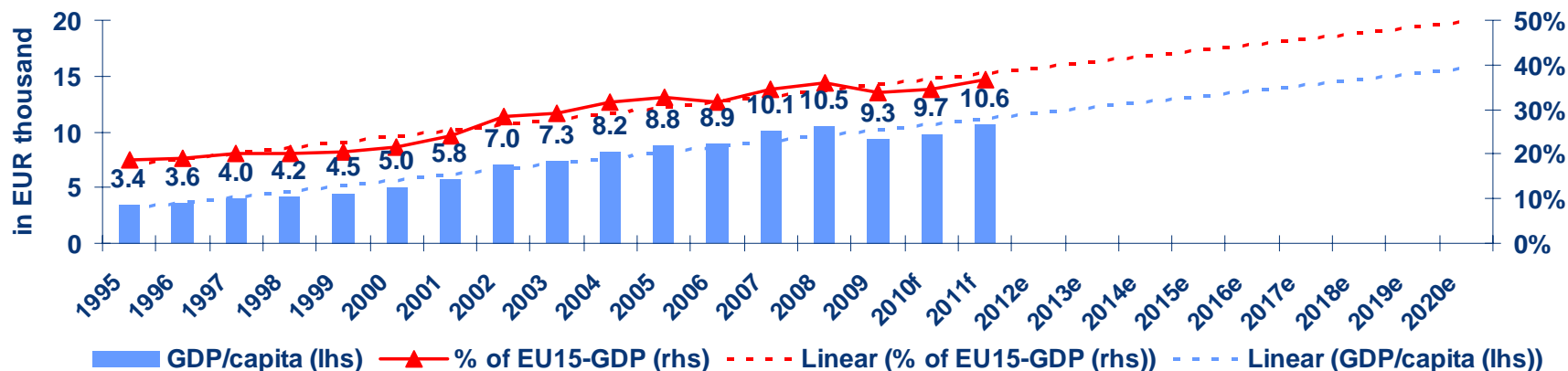
– Post-acquisition track record of EB Hungary

- Long-term financial performance
- Analysing credit risk
- Conclusion

Economic and political timeline –

Catching up to EU15 thanks to stable economic growth

Hungary - GDP/capita vs % of EU15 GDP/capita



1994-98 Horn (left)

- » Early years: economic growth driven by high public spending
- » “Bokros package” launched in '95 to balance foreign and internal debt
- » Privatisation of banking and utility sector launched

1998-02 Orban (right)

- » OECD membership
- » GDP led by export
- » Economic development plan implemented
- » Introduction of state-subsidised mortgage
- » Successful entry into NATO

2002-09 Medgyessy – Gyurcsany (left)

- » Successful entry into EU
- » Medgyessy: “Change of welfare regime” programme, increased budget spending until 2004
- » Gyurcsany government introduced austerity package to reduce government debt
- » Minority government after break up of coalition in 08
- » Signing of IMF-EU-WB loan agreement

2009-10: Bajnai (crisis mgmt)

- » Entering Schengen area (no travel restrictions)
- » Austerity measures hit domestic demand and led to rise in unemployment
- » Global downturn halts the economic boom

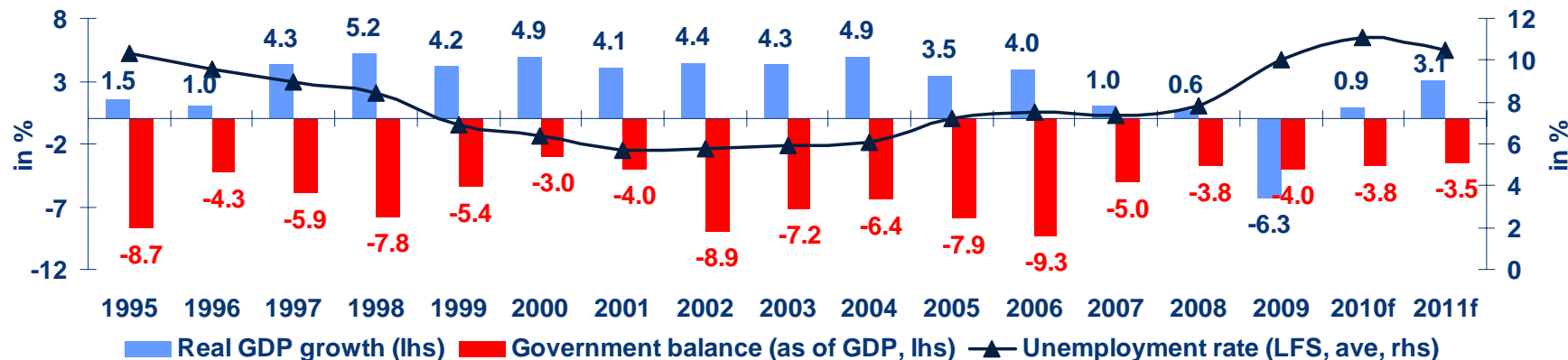
since 2010: Orban (right)

- » Unemployment to remain elevated for longer
- » Government intends to keep fiscal deficit at 3.8% in 2010
- » Banking tax
- » Plan to cut personal income taxes from 2011
- » Intention to finance deficit from the market, without IMF help

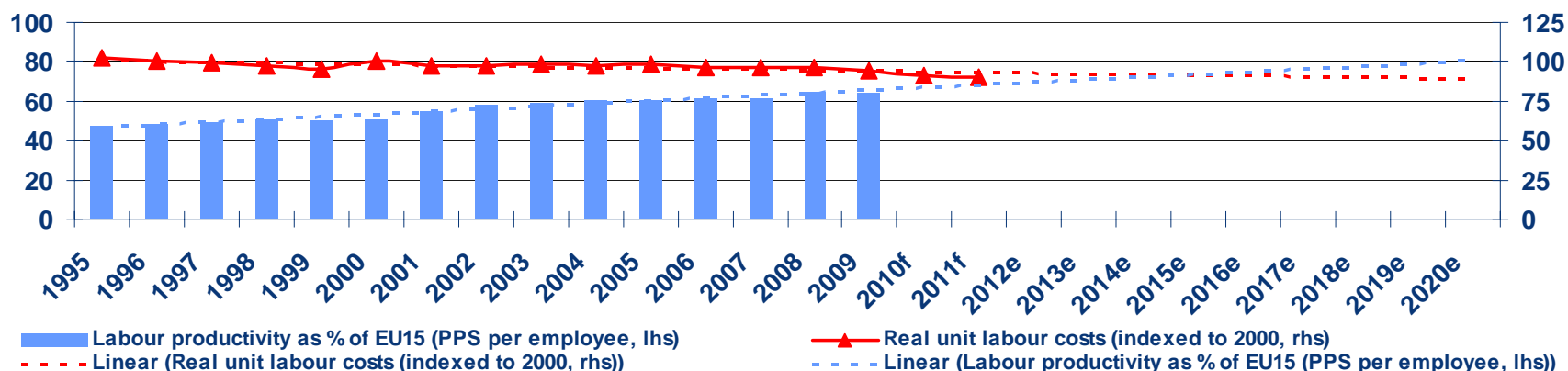
Source: Eurostat, Erste Group Research

Economic scorecard: the real economy – Improved fiscal discipline since 2007

Hungary - Real GDP growth vs fiscal balance vs unemployment rate



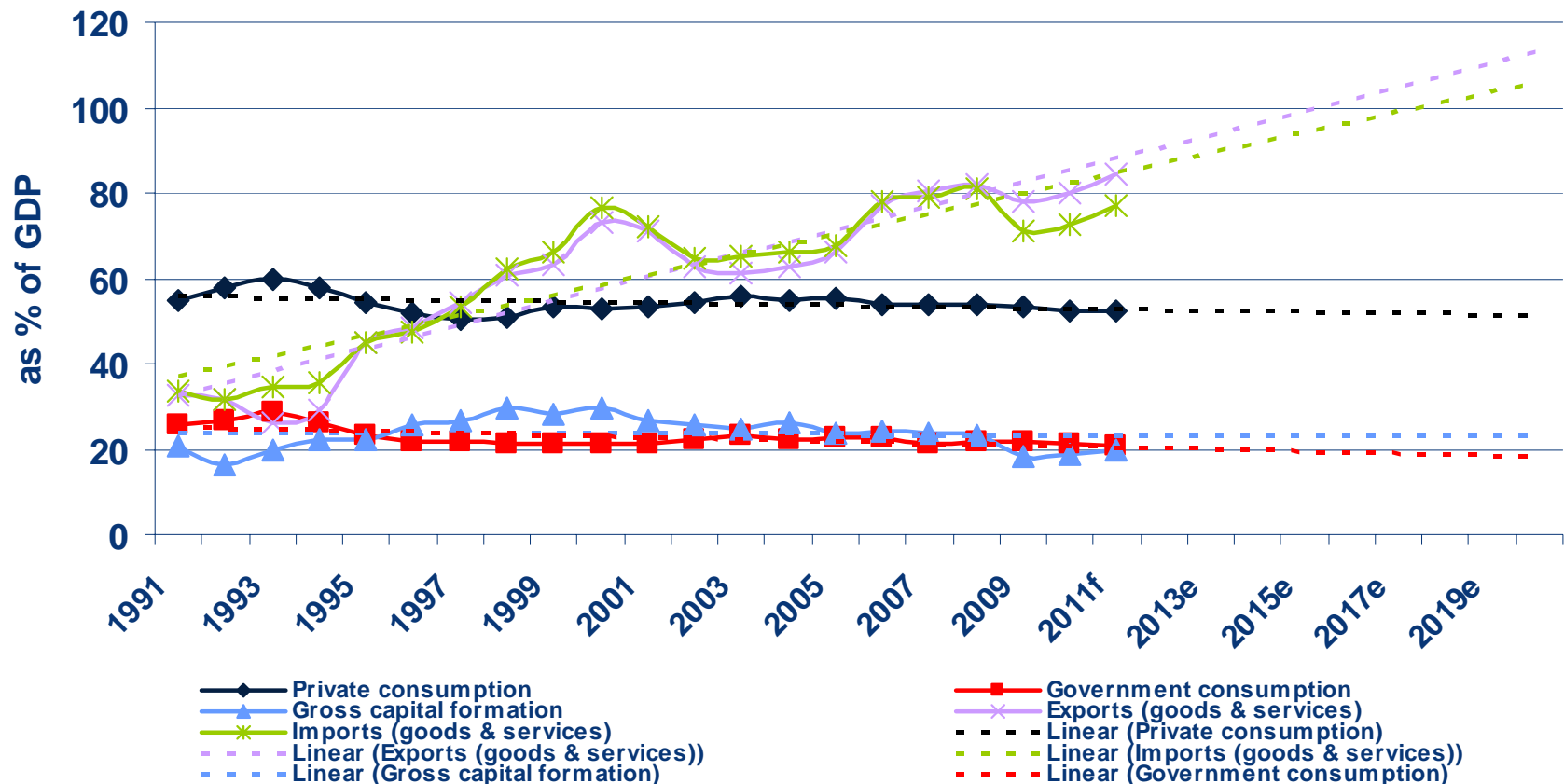
Hungary - Labour productivity vs real unit labour costs



Source: Eurostat, Erste Group Research

Economic scorecard: GDP composition – Exports drive economy

Hungary: Composition of GDP - expenditure approach



Source: Eurostat

Economic scorecard: trade drilldown –

Trade focused on Europe/Germany

– Hungary is an export oriented country

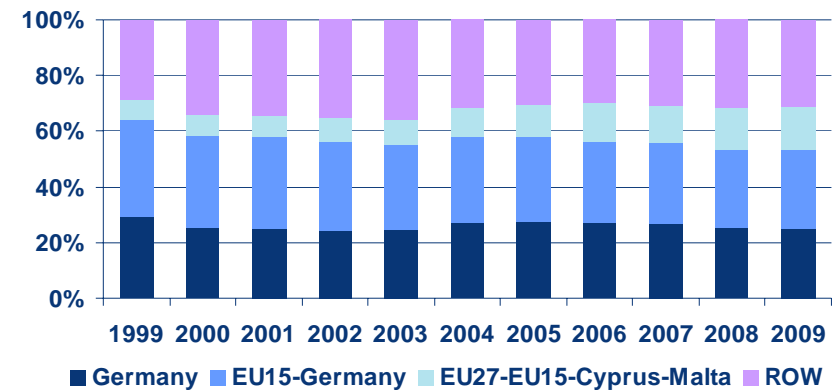
- Export of goods accounts for 64% of GDP (80% including services)
- Exports related to processing industry are another key driver of the economy
 - Manufacturing industry represents nearly one fifth of total GDP
- Significant part of imports is processed and then re-exported
- During recession imports declined more than exports
 - Net trade surplus (over 4% of GDP) eased the fall of the economy

– Germany is still Hungary's largest export partner

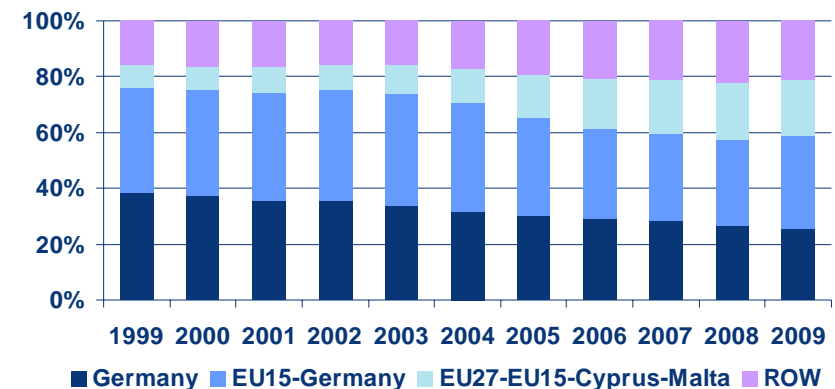
- Although share of CEE markets has been growing since EU accession

– Main trade items are machinery and transport equipment

Hungary - Goods import distribution



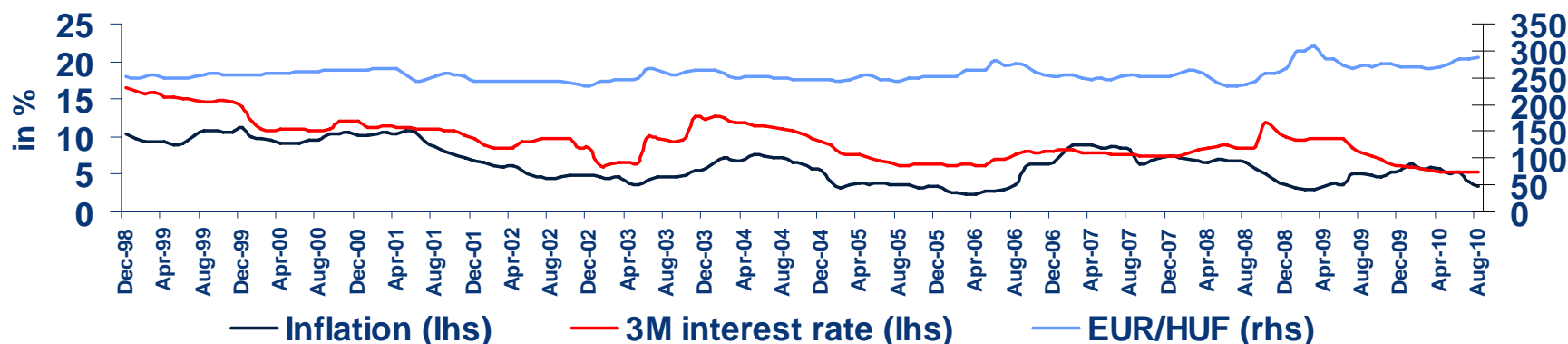
Hungary - Goods export distribution



Source: Eurostat

Economic scorecard: monetary policy – “Tighten up - loosen up” cycles

Hungary: Inflation, interest rate, exchange rate



1994-98 Horn (left)

- » Huge C/A and budget deficit - stabilisation of FinMin Bokros in 1995
- » One-time 9% devaluation of HUF, “crawling peg” with 4.5% fluctuation band
- » Inflation above 30% in '95, below 15% in '98
- » 3M rate dropped to 15% from above 23% in '95
- » No recession due to stabilisation

1998-02 Orban (right)

- » Inflation stuck near 10% from 1998-2001
- » Inflation targeting regime adopted in 2001, crawling peg abandoned – CPI started to ease
- » No GDP slowdown in the early 2000's global recession due to fiscal stimulus

2002-09 Medgyessy – Gyurcsany (left)

- » 2002-2006: loose fiscal policy and tight monetary policy
- » High interest rates also encouraged FX lending
- » Policy error in 2003: switching of HUF fluctuation band needed large rate hikes
- » CB fight for credibility
- » 2006 consolidation: increasing taxes and higher inflation hampered growth

2009-10: Bajnai (crisis mgmt)

- » Immediate need for consolidation of budget
- » Demand pressures lower but higher taxes increased CPI
- » HUF strengthened on better investor sentiment and measures
- » Base rate dropped from 9.25% to record low of 5.25%

since 2010: Orban (right)

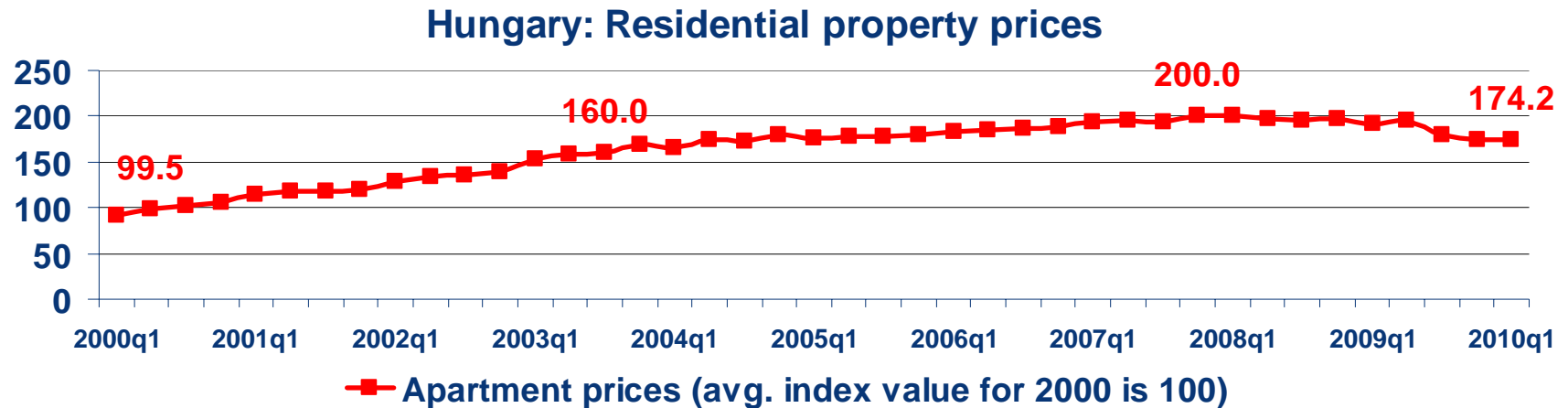
- » Higher risk premia also due to domestic factors
- » Weak local currency compared to EUR
- » Govt. and CB tensions
- » Risks of a rate hike increased
- » Domestic demand driven price pressures but risks for food & energy prices

Source: Eurostat, Bloomberg

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- **Hungary has seen improvement in living standards as measured by several social indicators:**
 - Life expectancy increased by 4-5 years since the fall of the socialist system
 - Men: from 65 years to 70 years
 - Women: from 74 years to 78 years
 - Homes with access to communal services has grown by 10%-30% points since 1990
 - Dwellings with access to drinking-water conduits (as % of total) improved to 95% from 85%
 - Dwellings with access to sewerage system (as % of total) improved to 71% from 42%
 - Number of reported crimes fell from 450,000 per annum in 2000 to 393,000 in 2009
 - Enrolment in high education grew from 184,000 in 2001 to 223,000 in 2009
 - Significant highway expansion from 571km in 2001 to 1280km in 2010

Focus: residential real estate development –

High home-ownership but low mortgage penetration



- **Dynamic mortgage lending did not lead to unsustainable rise in property prices**
 - Prudent lending policy
 - Real estate prices dropped approx. 10-20% in 2009 as a result of economic downturn
 - Stagnating prices in 2010
- **Very high home ownership ratio: >90%**
- **Only 40% of homes have mortgages**
 - Representing lending potential
- **Lending activity and real estate price growth expected to pick up in 2011**

Source: FHB House Price Index

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– Evolution of the banking market

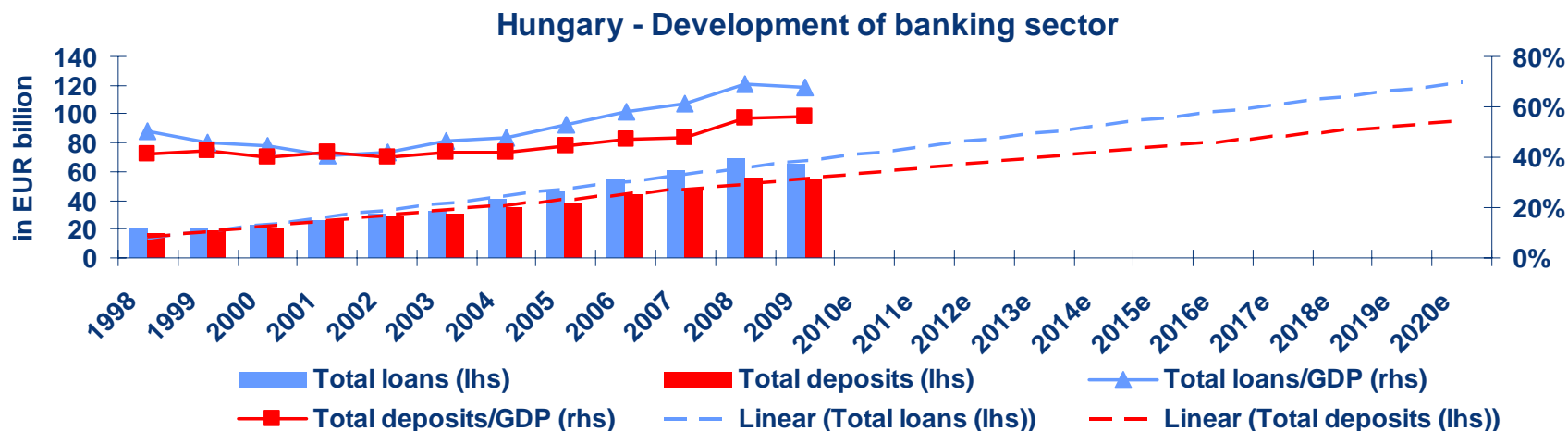
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Evolution of the banking market –

From state owned banking to competitive market



1987 - 1991

mid '90s - 2000

2000 - 2008

Beyond 2008

» Formation of two-tier banking system

» Focus on corporate banking, retail market maturity low

» Simple banking services (mainly current account)

» Strong M&A activity and bank consolidation (ABN+KH, Citi+ING)

» Boom in corporate banking (lending)

» Introduction of electronic banking and call centre services

» Largest banks strengthen their position in Hungary
 » OTP becomes regional player
 » CIB-IEB merger
 » Retail banking focus through 3rd party sales and extended branch network

» Growing presence of investment fund products, mortgage backed lending

» Market consolidation set to continue (exit of some players possible)

» After downturn, increased focus on retail segment (deposit collection due to lack of liquidity)

» Strategic partnerships

Source: National Bank of Hungary

The emergence of retail banking – Moving away from the cash economy

– Usage of current accounts

- Widespread use since 2003
- Civil servant salaries transferred to current accounts

– Electronic banking has improved rapidly

- Emergence of websites, phone and online banking – rapid take-up since 2005
- Banks encourage customers to use e-banking
- Today roughly 2.4m transaction/month, out of which only 144 thousand are paper-based

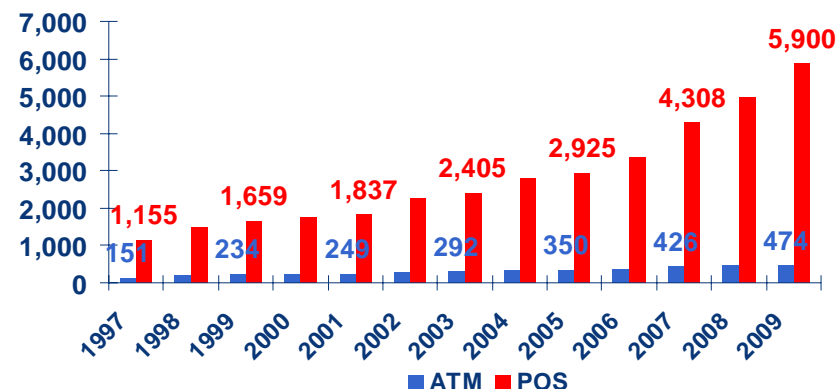
– Hungary skipped the chequebook

- Chequebooks not used in Hungary

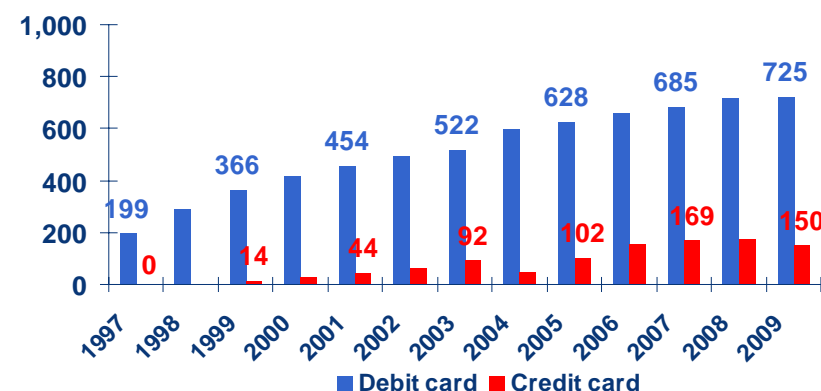
– ATM/POS

- Dramatic growth in ATMs and POS terminals
- Increased credit card usage since 2006

ATMs and POS per 1m inhabitants



Payment cards per 1,000 inhabitants



Source: National Bank of Hungary

The emergence of retail banking – The loan growth story

– Economic growth and government politics changed household saving/spending behaviour in late 1990s

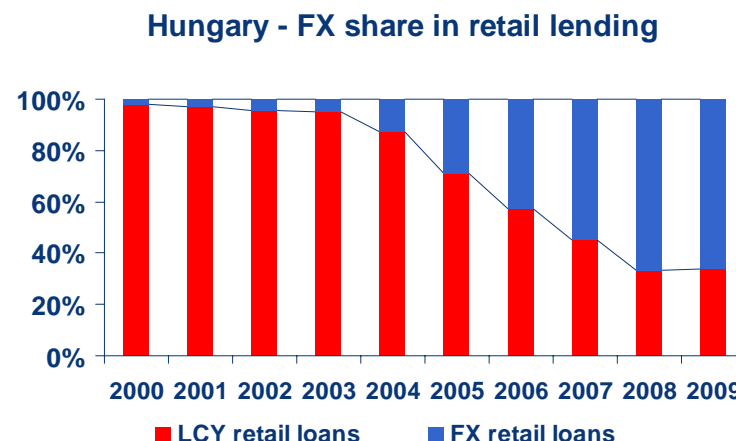
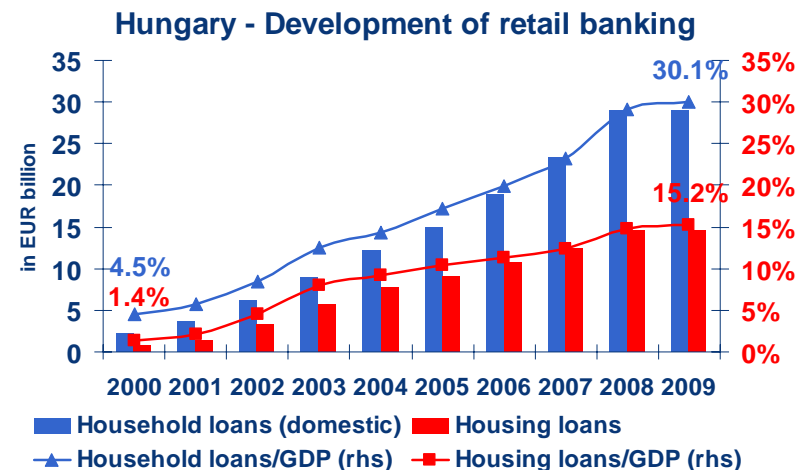
- Positive outlook for the future; growing aspirations to achieve higher living standards
- Growth potential on the corporate side decreased, hence banks shifted to retail banking to exploit opportunities

– Volume of household loans increased 5x between 2001-2006

- During this period retail loans to GDP increased from 6% to 20%

– FX lending phased out in 2008-2010

- Discontinuation of CHF lending as of end 08
- EUR lending in focus in 2009 but HUF gained ground in H1 2010 in line with risk restrictions
- FX mortgage registration abolished in July 10



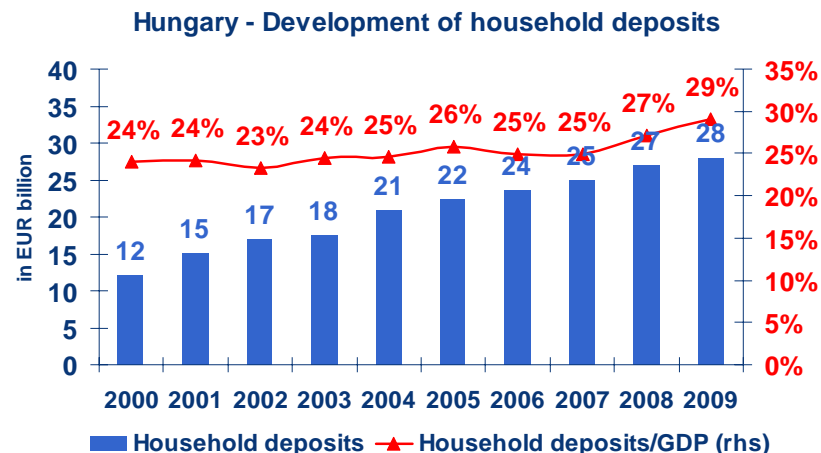
Source: National Bank of Hungary

The emergence of retail banking –

Wealth creation: from deposits to fund management

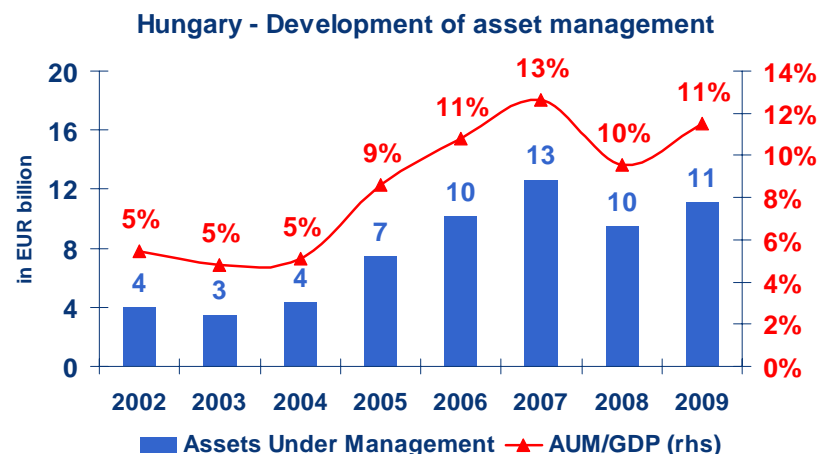
– **Despite consistent growth, Hungary's retail deposit market still lags behind that of other CEE countries**

- Mainly due to societal savings habits
- Unlike some other CEE countries (Croatia, Romania), vast majority of deposits are based in local currency
- Increased focus on deposit collection since beginning of downturn



– **Asset management has developed well despite crisis-related disruption during crisis**

- AuM volume tripled between 2002-2007, supported by extensive branch network
- Introduction of private banking
- HUF-based funds preferred over foreign currency denominated funds
- State-supported longer term investment products have gained popularity
- Funds per capita at EUR 1,100

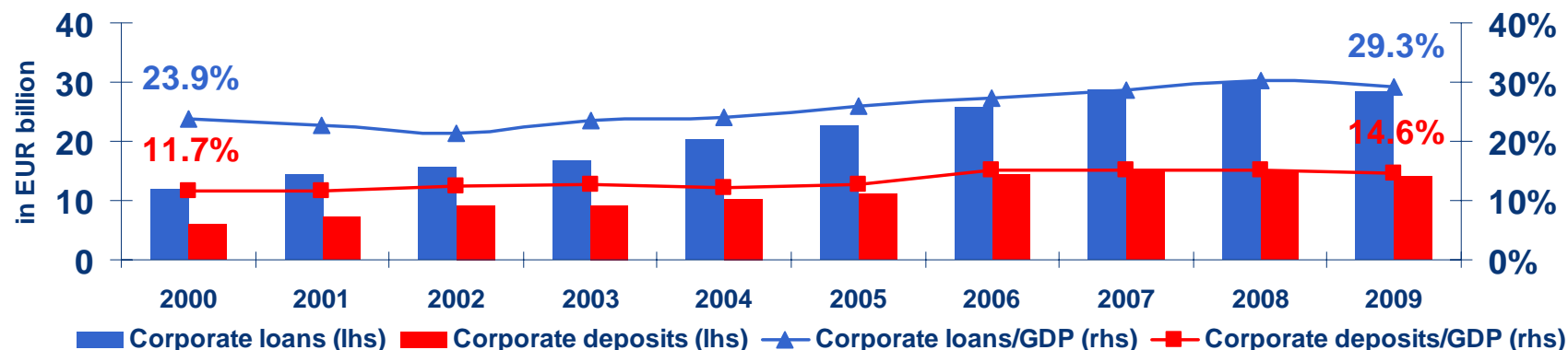


Source: National Bank of Hungary

The transformation of corporate banking –

Economic growth is main driver of corporate market

Hungary - Development of corporate banking



– Corporate loans: from fragmented market to 8-10 large banks by late 1990s

- Top 8 banks hold 75 % market share
- 60% of corporate loans are HUF-based
- CAGR (2000-2009): 10%

– Corporate deposits show big potential

- Low level of corporate deposit penetration compared to EU15
- Loan/deposit ratio in the corporate sector is 200%
- CAGR (2000-2009): 10%

Source: National Bank of Hungary

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Post-acquisition track record of EBH – Long-term financial performance*

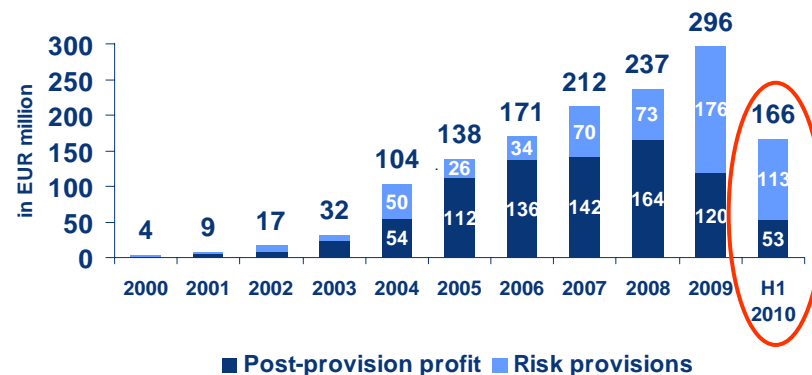
– Erste Group's first acquisition in CEE: Mezobank in 1997

- At the time of acquisition, the bank had market shares of approximately 4%
- Postabank acquisition in 2004
- Today, Erste Bank Hungary is the country's second largest retail bank

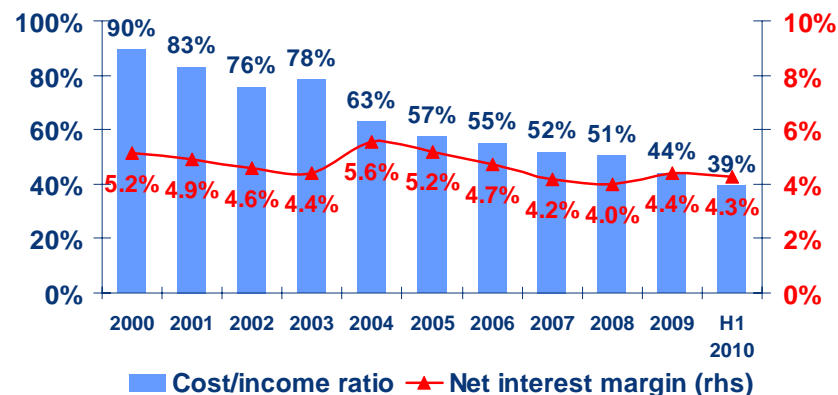
– Very impressive financial performance despite sluggish macroeconomic environment

- Operating profit increased year on year
- Cost/income ratio decreased to 39%
- Net interest margin relatively stable despite changing interest rate environment
- Erste Bank Hungary has always been profitable

EB Hungary: operating profit history
(pre-provision profit)



EB Hungary: CIR and NIM



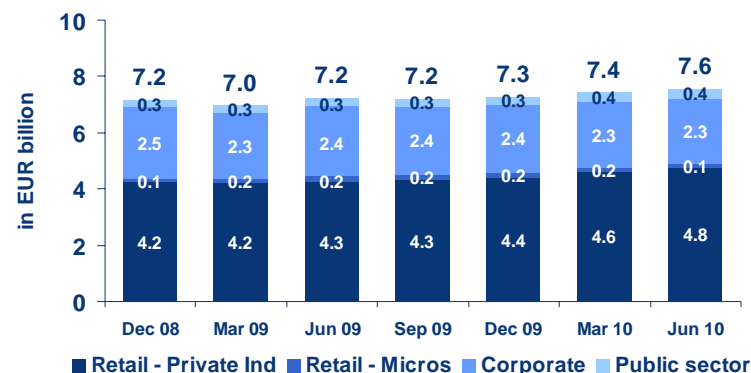
*) Based on local consolidated IFRS data

Post-acquisition track record of EBH –

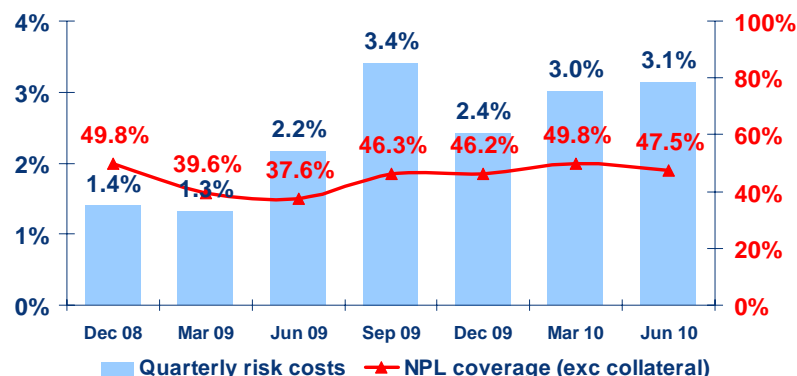
Analysing credit risk*

- **Customer loan growth impacted by weak demand and regulatory changes**
 - New loans are entirely HUF-based
 - Very high share of existing portfolio is backed by collateral
- **Currency volatility and still weak macroeconomic environment has negatively impacted asset quality**
 - Limited HUF-based new business could not offset deterioration of existing portfolio
 - Despite increasing NPL-ratio, NPL-coverage maintained during the economic downturn and expected to increase
 - Due to conservative risk policy current average LTV of 56.3%
- **Risk costs still at elevated levels**
 - Mainly due to higher risk costs in leasing and real estate

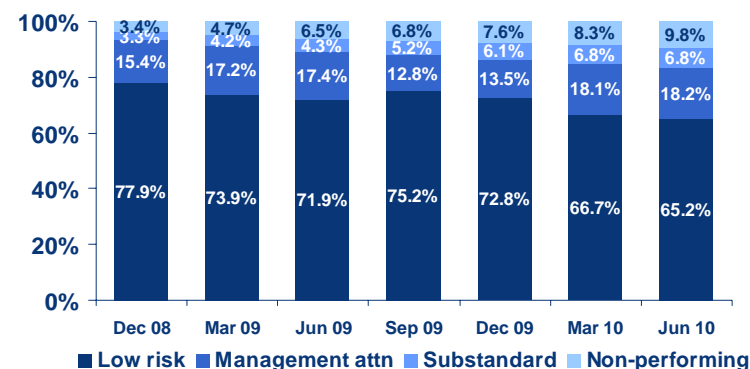
Segment Hungary -
Customer loans by Basel II customer segment



Segment Hungary -
Risk costs vs NPL coverage



Segment Hungary - Migration analysis



*) Based on segment figures.

– **Macroeconomic recovery set to continue**

- Real GDP expected to grow in 2010 driven mainly by exports
- Forint has stabilised recently after reaching record low versus CHF
- Budget deficit targets to be kept irrespective of outcome of IMF negotiations
 - 3% of GDP in 2011
- Government to announce specific measures following yesterday's municipality elections

– **Banking market impacted by government policies**

- Government measures significantly changed Hungary's banking business
 - Implementation of a banking tax in the amount of EUR 770m
 - Abolition of FX-based mortgage registration
- HUF-based loans gained in popularity already before the new regulation on FX lending

– **EB Hungary to make necessary steps in order to deal with new conditions**

- Strong operating performance expected to continue
- Further cost saving measures to be implemented to partly offset elevated risk costs and additional expenses related to banking tax