

RATING ACTION COMMENTARY

Fitch Maintains Erste's 'A' Long-Term IDR on RWN

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Fitch Ratings - Frankfurt am Main - 01 Oct 2020: Fitch Ratings has maintained Erste Group Bank AG's 'A' Long-Term Issuer Default Rating (IDR) on Rating Watch Negative (RWN).

The RWN of Erste reflects continued near-term risks to ratings from the likely deterioration of its financial profile as a result of the economic fallout from the coronavirus pandemic. Fitch expects to resolve the RWN in 4Q20, by which time 3Q20 results should provide greater visibility of the pandemic's impact on several factors that are important to the bank's ratings. These are notably prospects for asset quality, in particular in central and eastern European (CEE) markets, which entered the economic downturn caused by the pandemic later than most western European countries; the resilience of Erste's revenue base in light of likely decreasing net interest margins; and the resilience of Erste's capital to potential risk-weighted assets (RWA) inflation.

KEY RATING DRIVERS

IDRs, Viability Rating, Derivative Counterparty Rating and Long-Term Debt Ratings

Unless noted below, the key rating drivers for Erste are those outlined in our Rating Action Commentaries published in April 2020 ('Fitch Takes Rating Action on Three Austrian Banking Groups on Coronavirus Disruption') and June 2020 ('Fitch Takes Action on Erste's SNP Debt Rating on Updated Criteria').

Erste entered the economic downturn with a strengthened financial profile driven by benign economic conditions in its core markets over the past six years, non-performing loans (NPL) workout and tightened underwriting and risk controls. At the same time, banking sectors in Erste's core markets are in a much better fundamental position than they were prior to the global financial crisis (GFC). Credit growth has been moderate in recent years and risk-taking has therefore been disciplined. Hence, the upcoming NPL trend should be less severe. Foreign-currency credit risks are significantly lower than before the GFC. Capital buffers are much higher (incl. additional capital buffer build-up in faster-growing markets). In addition, local (re)financing has been significantly strengthened in recent years and there has been no external cross-border funding leverage as before the GFC.

Erste's CEE core markets have so far managed well through the crisis and, with the exception of Romania, have at disposal more fiscal headroom than many of their western European peers. In the medium-term CEE countries will also be the largest recipients of the 'Next Generation EU' funds, which is expected to boost investments and growth in the region. However, we believe it is too early to exclude a near-term risk for Erste's operating environment due to the recent rise in COVID-19 infections in Austria, Czech Republic, Hungary and Croatia, the possibility of renewed large-scale lockdowns and the extension of fiscal measures that have so far absorbed a large part of the economic impact.

Erste's impaired loans ratio slightly decreased to 2.27% at end-1H20. At the same time, Stage 2 gross loans more than doubled to EUR26 billion compared with end-2019, or 15.5% of gross loans. We expect an increase in borrower defaults in the bank's large Austrian and CEE SME portfolios and in its exposures most affected by the crisis in the near term. However, it is still unclear how many loans will migrate to NPLs following the end of the moratoria in Erste's markets.

Profitability has suffered from high provisioning for Stage 2 loans and losses in the fair-value portfolios in 1H20, but revenues were overall resilient. We expect net interest income to slightly decline in 2H20 as the drawing of TLTRO III will not compensate for interest-rate cuts in the Czech Republic, Hungary and Romania.

Net commission and trading income should recover in 2H20 but remain below last year's level on a full-year basis. Erste has indicated loan impairment charges (LICs) of 65bp-80bp of gross loans in 2020 in its baseline scenario, assuming GDP deterioration between 4% and 9% in its core markets. However, the evolution of LICs in 2021 remains unclear and depends on how fast the economies will recover.

At the same time, Erste expects operating expenses to slightly decline yoy. We also maintained the bank's capitalisation score on negative outlook to reflect potentially

sizable negative rating migrations, although the bank has recently confirmed its 13.5% medium-term CET1 ratio target.

RATING SENSITIVITIES

Unless noted below, the key rating sensitivities for Erste are those outlined in our Rating Action Commentaries published in April 2020 ('Fitch Takes Rating Action on Three Austrian Banking Groups on Coronavirus Disruption') and June 2020 ('Fitch Takes Action on Erste's SNP Debt Rating on Updated Criteria').

The RWN on Erste's ratings reflects the near-term risks arising from the coronavirus outbreak and the heightened probability of a downgrade. Its earnings resilience is based on geographic diversification in more advanced CEE economies, which we believe will come under pressure from economic disruptions in the region. This means Erste has moderate rating headroom to offset pressure on its earnings and ultimately on its capitalisation.

We expect to resolve the RWN in 4Q20, when the impact of the outbreak on the bank's credit profile becomes more apparent and 3Q20 results will be available.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Sustained asset-quality deterioration; sustained pressure on operating profitability from lower revenues and higher loan impairment charges; or a further downward revision of Fitch's Outlook for the Austrian and CEE economies. In resolving the RWN, Fitch will assess the extent to which compensation by governments for direct pandemic-related losses in Erste's main markets will cushion the financial impact on the bank's asset quality, earnings and solvency.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The RWN could be removed and the ratings affirmed if the disruptions are short-lived and the impact on Erste's financial profile turns out to be immaterial. In the event Erste is able to withstand rating pressure arising from the coronavirus outbreak, the most likely trigger for an upgrade would be an improvement of asset-quality metrics and earnings generation, together with higher capital ratios.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Erste Group Bank AG	LT IDR	A Rating Watch Negative	Rating Watch Maintained	A Rating Watch Negative
	ST IDR	F1	Affirmed	F1

ENTITY/DEBT	RATING	PRIOR
	Viability	a Rating Watch Negative
		Rating
		Watch
		Mainta
		a Rating
		Watch
		Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

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Erste Group Bank AG

EU Issued

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