FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Erste Group at 'A'; Stable Outlook

Mon 17 Oct, 2022 - 10:18 AM ET

Fitch Ratings - Frankfurt am Main - 17 Oct 2022: Fitch Ratings has affirmed Erste Group Bank AG's (Erste) Long-Term Issuer Default Rating (IDR) at 'A' with a Stable Outlook, and Viability Rating (VR) at 'a'. The Short-Term IDR has been affirmed at 'F1'. A full list of ratings is detailed below.

Fitch has withdrawn Erste Group's Support Rating and Support Rating Floor as they are no longer relevant to Fitch's coverage following the publication of its updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned Erste Group a Government Support Rating (GSR) of 'no support' (ns).

KEY RATING DRIVERS

Erste's Long-Term IDR is driven by its VR. The VR is one notch above the implied VR, reflecting the high importance for Erste's ratings of the group's diversified business profile, which is underpinned by its leading franchise in retail and SME banking in Austria and central and eastern Europe (CEE).

The ratings also reflect the group's resilient asset quality, strong earnings, adequate capitalisation and stable funding. The group's material operations in less developed and more volatile countries in CEE translate into a slightly weaker operating environment compared with that of peers that solely focus on Austria. As a result, Fitch expects stronger financial metrics from Erste than from purely Austrian-focused peers to maintain a VR of 'a'.

Recession Risk in 2023: Surging energy prices and persistent supply-chain disruptions drove inflation to a multi-decade high in 9M22, with an expected dampening effect on economic growth in the next quarters. Further escalation of the Ukrainian conflict leading to severe restrictions to oil and gas supply could lead to a recession in Austria, the Czech Republic, Hungary and Slovakia and inflate Erste's loan-impairment charges (LICs) over the next two years.

Business Profile Drives Ratings: Erste's universal-banking business model and leading franchise in retail and SME banking in Austria, the Czech Republic, Slovakia and Romania provide stability to the group's overall credit profile. We believe that these markets will continue to deliver good risk-adjusted returns over the cycle and view the bank's consistent strategic commitment to the region as positive for the ratings.

Good Risk Controls: Erste's generally prudent risk appetite is supported by the predominance of its Austrian and Czech exposures. Credit standards are broadly in line with market practice in Austria, but are more stringent than local peers' in CEE, underpinned by the group's centralised, sophisticated risk control framework. Structural interest-rate and foreign-currency risks are modest.

Political risks will remain a source of unpredictability but manageable for Erste's earnings in CEE because the sound profits of the region's banking sector represent an attractive source of funds to fill the governments' budgetary gaps.

Resilient Asset Quality: Erste's impaired loan ratio continued to decline to 2.1% at end-1H22. Rising interest rates, high inflation and a possible halt to Russian gas supplies to the EU will likely increase the impaired loans ratio in the next two years.

At the same time, we expect Erste's four-year average impaired loans ratio to remain below 4%, a level commensurate with an asset quality score of 'bbb+'. This is because asset quality benefits from adequate collateralisation of its loan book and comfortable impaired loans coverage, which will likely be increased by precautionary provisions in 2H22.

Strong Revenue Growth: Erste's earnings benefit from geographic and product diversification. We expect operating profit to be 2.2% of risk-weighted assets (RWAs) in 2022, driven by strong business growth and rising interest rates. Higher interest rates will sustain revenue growth also in the next two years, albeit at a slower pace due to declining demand from corporates and households, repricing of deposits and maturing of central-bank tenders (TLTRO).

Higher cost inflation and loan impairment charges (LICs) will weigh on profitability in the next two years, but we believe that Erste's earnings will continue to benefit from sound operating margins and growth potential in the group's markets in the long term.

Adequate Capitalisation: Erste's fully loaded common equity Tier1 (CET1) ratio of 14.2% at end-1H22 is commensurate with the group's risk profile. Capitalisation benefits from strong retained earnings, low unreserved impaired loans, moderate concentrations and good capital-market access.

Higher credit risk could offset profit retention, pressuring the CET1 ratio towards management's 13.5% target, but we expect the bank to implement capital-enhancing measures should the ratio fall below its target. Erste's leverage ratio of 6.3% is higher than large European peers', due to the higher RWAs density in CEE.

Stable Funding; Comfortable Liquidity: Erste's funding benefits from its strong deposit franchise, which limits the bank's reliance on capital markets. Ample, high-quality liquidity reduces refinancing risk. We believe Erste's multiple-point-of-entry (MPE) resolution strategy limits intra-group contagion risk and supports the group's policy of largely self-funded CEE operations. The MPE strategy does not constrain intra-group support, in our view, as we expect Erste to pre-emptively support its foreign subsidiaries if needed.

RATING SENSITIVITIES

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

We could downgrade the VR and Long-Term IDR if asset quality and operating profitability deteriorate substantially and on a sustained basis, most likely due to severe damage to the SME-and-corporate loan portfolios. In particular, an impaired loan ratio above 5% or operating profitability/RWAs materially below 2% on a sustained basis would lead to a downgrade.

We would also downgrade the ratings if the CET1 ratio falls below its 13.5% target on a sustained basis. Erste's Short-Term IDR would be downgraded if both Erste's Long-Term IDR and funding and liquidity score are downgraded.

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

Rating upside for Erste is limited in the medium term. An upgrade of its VR and Long-Term IDR and debt ratings would require an improvement of its operating environment in CEE, stronger asset-quality metrics and earnings generation, together with higher capital ratios.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Erste's Derivative Counterparty Rating (DCR) and senior preferred (SP) debt ratings are aligned with its IDRs and its senior non-preferred (SNP) debt is rated one notch below its Long-Term IDR to reflect the risk of below-average recoveries for SNP creditors in a resolution. This is because we expect Erste to use SP debt to meet its resolution buffer requirements, and we do not expect SNP and more junior debt to sustainably exceed 10% of the Austrian resolution group's RWAs. The Tier 2 debt is rated two notches below the VR to reflect subordinated creditors' above-average loss severity.

Erste's Short-Term IDR of 'F1' is the baseline option mapping to a Long-Term IDR of 'A', and reflects the group's robust funding & liquidity, which we score at 'a'. The rating of Erste Finance (Delaware) LLC's commercial paper programme is aligned with Erste's Short-Term IDR, based on Erste's guarantee of the programme.

Erste's 'ns' GSR reflects Fitch's view that senior creditors can no longer rely on full extraordinary state support. This is driven by the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism, which provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead, or ahead, of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Erste's DCR and long-term debt ratings are sensitive to changes in the bank's Long-Term IDR and VR. The DCR and the long-term SP and SNP debt ratings could also be upgraded by one notch above the Long-Term IDR if we expect Erste's SNP and more junior debt buffers to sustainably exceed 10% of the Austrian resolution group's RWAs.

Erste's Short-Term IDR and short-term SP debt rating, as well as Erste Finance (Delaware) short-term unsecured debt rating, would be downgraded if both Erste's Long-Term IDR and funding and liquidity score are downgraded. An upgrade of the short-term ratings requires an upgraded of Erste's funding and liquidity score to 'aa-' or above.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. This is highly unlikely in light of the prevailing regulatory environment, in our view.

VR ADJUSTMENTS

The operating environment score of 'a' is below the 'aa' category implied score due to the following adjustment reason: international operations (negative).

The earnings & profitability score of 'a' is above the 'bbb' category implied score due to the following adjustment reason: revenue diversification (positive)

The funding & liquidity score of 'a' is above the 'bbb' category implied score due to the following adjustment reason: deposit structure (positive)

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 Affirmed	A Rating Outlook Stable	A Rating Outlook Stable

	ST IDR	F1	Affirmed	F1
	Viability	a	Affirmed	a
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	DCR	A(dcr)	Affirmed	A(dcr)
	Government Support	ns	New Rating	
subordinated	LT	BBB+	Affirmed	BBB+
Senior preferred	LT	A	Affirmed	A
Senior non-preferred	LT	A-	Affirmed	A-

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Roger Schneider
Director
Primary Rating Analyst
+49 69 768076 242
roger.schneider@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Marco Diamantini
Associate Director
Secondary Rating Analyst

+49 69 768076 114
marco.diamantini@fitchratings.com

Christian Kuendig
Managing Director
Committee Chairperson
+44 20 3530 1399
christian.kuendig@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Erste Finance (Delaware) LLC	EU Issued, UK Endorsed
Erste Group Bank AG	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link:

https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters.

Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by

Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Banks North America Europe Austria United States