FitchRatings

Banks
Universal Commercial Banks
Austria

Erste Group Bank AG

Update

Key Rating Drivers

Business Profile Drives Ratings: Erste Group Bank AG's (Erste) ratings reflect its leading franchise in retail and SME banking in Austria and central and eastern Europe (CEE), resilient asset quality, strong earnings, adequate capitalisation and stable funding. The group's material operations in CEE translate into a slightly weaker operating environment compared with that of peers that solely focus on Austria. As a result, Fitch Ratings expects stronger financial metrics from Erste than from purely Austrian-focused peers to maintain a Viability Rating (VR) of 'a'.

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. Structural interest-rate and foreign-currency risks are modest. Political risks will remain a source of unpredictability but will remain 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: Rising interest rates, high inflation and sluggish economic growth 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 the asset quality score of 'bbb+'. This is because asset quality benefits from adequate collateralisation of the loan book and comfortable impaired loans coverage.

Strong Profit Growth: Operating profit increased to 2.8% of risk-weighted assets (RWAs) in 1Q23 (1Q22: 1.8%), largely driven by rising interest rates. We expect higher interest rates to sustain revenue growth throughout 2023 and 2024, compensating cost inflation and higher loan impairment charges (LICs). 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 14.4% at end-2022 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, pushing the CET1 ratio towards the 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 6.6% at end-2022 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.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Derivative Counterparty Rating	A(dcr)
Viability Rating	a
Government Support Rating	ns

Sovereign Risk (Austria)	
Long-Term Foreign-Currency IDR	AA+
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Affirms Erste Group at 'A'; Stable Outlook (October 2022)

Erste Group Bank AG (November 2022)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

We could downgrade the ratings 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 would require an improvement of Erste's operating environment in CEE, stronger asset-quality metrics and earnings generation, together with higher capital ratios.

Other Debt and Issuer Ratings

Rating level	Rating
Senior non-preferred: long term	A-
Senior preferred: long term	A
Senior preferred: short term	F1
Subordinated: long term	BBB+

Source: Fitch Ratings

Erste's Derivative Counterparty Rating (DCR) and senior preferred (SP) debt ratings are aligned with its Issuer Default Ratings (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' reflects the group's robust funding and 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.

Significant Changes from Last Review

Strong 1Q23 Performance Underpins Earnings Growth

The increase in Erste's operating profit/RWAs ratio to 2.8% in 1Q23 (1Q22: 1.8%) was largely due to higher interest rates in all its markets.

Net interest income (NII) increased 27% yoy, driven by a sharp pick up in net interest margin (+36bp yoy to 2.50% in 1Q23,) and 12% loan growth in 2022, mainly from corporates and SMEs. Loan growth has subsided in 1Q23, with retail mortgages unchanged from the quarter before. Erste targets organic loan growth of about 5% in 2023 and acquired a EUR1.9 billion loan portfolio from Sberbank Europe's Czech subsidiary. Erste's management expects the reinvestment of the bank's large bond portfolio, along with slow repricing of deposits, to lead to about 15% yoy increase in NII in 2023.

Net commission income (NCI) increased 4.4% yoy, mainly driven by higher payment fees. We expect payment fees to grow also in the remainder of 2023 and view the bank's target of NCI growth of about 5% as plausible. The positive trading result was almost entirely offset by valuation losses in Erste's bond portfolio and own issuances.

Total non-interest expenses were up about 16% yoy, adjusted for a non-recurring EUR69 million deposit insurance contribution in 1Q22 related to the insolvency of Sberbank Europe AG. The increase was largely driven by higher bank levies and salaries. Erste expects operating expenses, excluding bank levies, to increase 9% yoy in 2023 due to inflationary pressures and currency appreciation in CEE.

Asset quality remained resilient in 1Q23, with impaired loans accounting for 2.1% of gross loans at end-1Q23, close to their record low. Erste released 4bp loan loss allowances in 1Q23 following recoveries and rating upgrades in its portfolio, and lowered its LIC guidance for 2023 to less than 25bp of gross loans (previously from guidance of less than 35bp). The revision mainly reflects the improved macroeconomic outlook and strong labour markets. We believe the updated guidance is reasonable, as the bank maintains substantial EUR900 million management overlays and macroeconomic model provisions (44bp of end-1Q23 gross loans).

Erste's commercial real estate (CRE) portfolio of EUR37.3 billion accounted for 18% of net customer loans at end-1Q23, with 53% of the exposure related to Austrian-focused residential real estate with an average loan/value (LTV) ratio of 48%, a third of which related to low risk state-subsidised, non-profit housing associations. The remaining CRE portfolio comprises mainly retail and office properties with average LTVs of 50% and 57%, respectively, and a moderate share of development. LTVs are based on mortgage values, with material haircuts from market values.

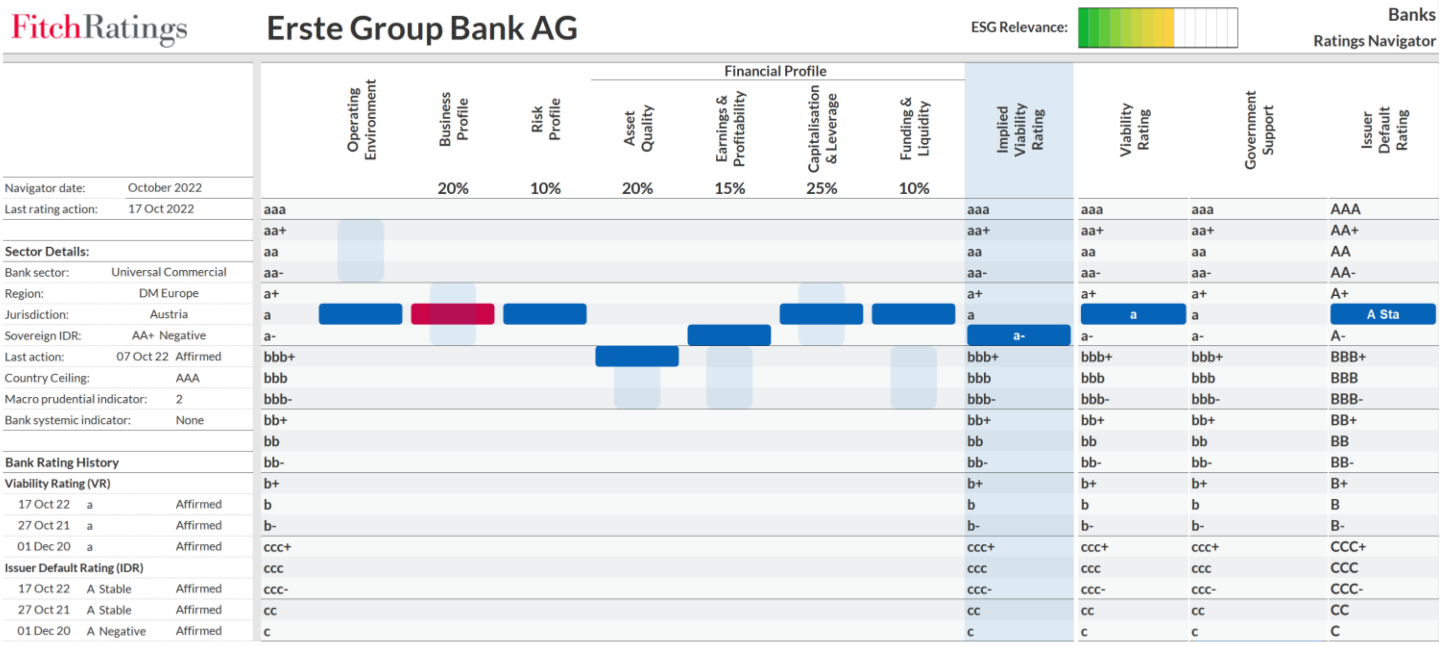
Erste's fully loaded CET1 ratio (end-1Q23: 14%) comfortably exceeds the regulatory requirement for 2023 of 10.81% and the management's floor of 13.5%. Erste is seeking regulatory approval for a EUR300 million share buyback, which would lower the bank's CET1 ratio by about 20bp at end-1Q23.

Stable, Diversified Funding and Slower Loan Growth Limit Liquidity Deployment

The perception of Erste as a safe haven led to customer deposits increasing by 5% in 1Q23, mainly driven by corporate clients. Retail clients still accounted for 65% of customer deposits at end-1Q23. Erste also funded EUR2.6 billion in 1Q23 out of EUR4 billion planned for 2023 through two covered bonds and a green senior preferred bond issuance. The focus in the remaining of 2023 will be on resolution buffers-eligible instruments both in public and private placement format.

The bank's liquidity remains sound and comprised EUR43 billion cash and another EUR55.1 billion bonds (combined equal to about 30% of total assets), with EUR43 billion of the bank's bond portfolio held at amortised cost. Rising interest rates increased unrealised valuation losses to about EUR4.5 billion at end-1Q23 (equivalent to about one fifth of CET1 capital). However, the bonds' moderate average maturity of 4.7 years, along with Erste's large central bank cash holdings and stable funding profile, minimise the risk of fire sales. Erste had EUR15.2 billion outstanding central bank tenders (TLTRO) at end-1Q23, which will reduce to EUR6.8 billion at end-2023.

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

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)

Financials

Financial Statements

	31 Mar 23		31 Dec 22	31 Dec 21	31 Dec 20
	3 months - 1st quarter (USDm)	3 months - 1st quarter (EURm)	Year end (EURm)	Year end (EURm)	Year end (EURm)
Summary income statement					
Net interest and dividend income	1,931	1,775	5,980	5,009	4,795
Net fees and commissions	699	643	2,452	2,304	1,977
Other operating income	88	81	63	397	390
Total operating income	2,718	2,499	8,495	7,709	7,162
Operating costs	1,651	1,518	4,973	4,617	4,441
Pre-impairment operating profit	1,067	981	3,522	3,092	2,721
Loan and other impairment charges	-23	-21	300	159	1,295
Operating profit	1,089	1,002	3,222	2,933	1,426
Other non-operating items (net)	2	1	0	0	-58
Tax	202	186	556	525	343
Net income	889	818	2,666	2,408	1,026
Other comprehensive income	399	367	-119	-6	-161
Fitch comprehensive income	1,288	1,184	2,547	2,402	864
Summary balance sheet					
Assets					
Gross loans	224,761	206,677	206,043	184,206	170,053
- Of which impaired	4,624	4,252	4,210	4,415	4,599
Loan loss allowances	4,360	4,009	3,981	3,938	4,003
Net loans	220,402	202,668	202,062	180,268	166,050
Interbank	29,688	27,299	18,482	21,001	21,466
Derivatives	2,013	1,851	1,840	2,338	3,165
Other securities and earning assets	67,015	61,623	59,695	52,503	45,366
Total earning assets	319,117	293,441	282,078	256,110	236,047
Cash and due from banks	47,094	43,305	35,685	45,495	35,839
Other assets	6,716	6,176	6,102	5,823	5,508
Total assets	372,927	342,921	323,865	307,428	277,394
Liabilities					
Customer deposits	254,575	234,092	222,575	209,895	189,801
Interbank and other short-term funding	41,910	38,538	35,163	34,750	27,592
Other long-term funding	36,504	33,567	30,960	29,894	29,124
Trading liabilities and derivatives	3,811	3,504	3,636	2,783	2,814
Total funding and derivatives	336,800	309,701	292,333	277,322	249,332
Other liabilities	7,327	6,738	6,227	6,593	5,651
Preference shares and hybrid capital	2,432	2,236	2,236	2,236	2,733
Total equity	26,368	24,247	23,069	21,277	19,677
Total liabilities and equity	372,927	342,921	323,865	307,428	277,394
Exchange rate		USD1 = EUR0.91954	USD1 = EUR0.93756	USD1 = EUR0.884173	USD1 = EUR0.821963

Source: Fitch Ratings, Fitch Solutions, Erste Group Bank AG

Key Ratios

	31 Mar 23	31 Dec 22	31 Dec 21	31 Dec 20
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.8	2.3	2.3	1.2
Net interest income/average earning assets	2.5	2.2	2.0	2.0
Non-interest expense/gross revenue	60.9	58.7	60.0	62.1
Net income/average equity	14.0	12.1	11.7	5.3
Asset quality				
Impaired loans ratio	2.1	2.0	2.4	2.7
Growth in gross loans	0.3	11.9	8.3	4.0
Loan loss allowances/impaired loans	94.3	94.6	89.2	87.0
Loan impairment charges/average gross loans	0.0	0.1	0.0	0.7
Capitalisation				
Common equity Tier 1 ratio	14.1	14.4	14.8	14.5
Fully loaded common equity Tier 1 ratio	14.0	14.2	14.5	14.2
Tangible common equity/tangible assets	6.6	6.6	6.5	6.6
Basel leverage ratio	6.2	6.6	6.5	6.7
Net impaired loans/common equity Tier 1	1.2	1.1	2.5	3.5
Funding and liquidity				
Gross loans/customer deposits	88.3	92.6	87.8	89.6
Liquidity coverage ratio	146.0	138.0	168.6	189.3
Customer deposits/total non-equity funding	75.7	76.3	75.6	76.0
Net stable funding ratio	139.0	139.1	150.2	n.a.

Source: Fitch Ratings, Fitch Solutions, Erste Group Bank AG

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A+ to A-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AA+/ Negative
Size of banking system	Neutral
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Neutral
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Neutral
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

Erste's 'no support' Government Support Rating 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.

Environmental, Social and Governance Considerations

Overall ESG

5	
4	
3	
2	
1	

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Environmental (E)

General Issues	Score	Impact	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1		n.a.	n.a.	5
Energy Management	1		n.a.	n.a.	4
Water & Wastewater Management	1		n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1		n.a.	n.a.	2
Exposure to Environmental Impacts	2		Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S)

General Issues	Score	Impact	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2		Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3		Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2		Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1		n.a.	n.a.	2
Exposure to Social Impacts	2		Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	Score	Impact	Sector-Specific Issues	Reference	G Scale
Management Strategy	3		Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3		Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3		Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3		Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
					1

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.

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

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