

**Rating Action: Moody's downgrades Erste Group Bank AG to Baa2 from Baa1; outlook negative**

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Global Credit Research - 05 Sep 2014

**Lowering of baseline credit assessment to ba1 from baa3 related to reduced internal capital generation**

Frankfurt am Main, September 05, 2014 -- Moody's Investors Service ("Moody's") has today downgraded the long-term senior unsecured debt and deposit ratings of Erste Group Bank AG (Erste) to Baa2 from Baa1 and affirmed the short-term debt and deposit ratings at Prime-2. The long-term ratings continue to incorporate two notches of systemic support uplift. The rating agency also affirmed Erste's standalone bank financial strength rating (BFSR) at D+, with the corresponding baseline credit assessment (BCA) revised to ba1, down from baa3. The outlook on the bank's BFSR is now stable.

The repositioning of Erste's BCA was driven by the bank's weak earnings trend and resulting significantly reduced internal capital generation, which is further pressured by ongoing high credit risk charges for its Hungarian and Romanian operations. The bank's still elevated ratio of non-performing loans (NPLs) of 14.1% for its operations in Central Eastern Europe (CEE) indicates sustained asset quality problems in this region. At the same time, Moody's believes that the bank's current capital provides sufficient cushion to absorb losses in a downside scenario, hence the stable outlook on the BFSR.

The outlook on Erste's long-term deposit and debt ratings remains negative, reflecting pressure on support resulting from the recent adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in the EU.

Moody's also downgraded Erste's hybrid and subordinated debt ratings by one notch to reflect the lowering of the bank's BCA. These ratings carry a stable outlook in line with the bank's BFSR. A list of affected ratings is provided at the end of this press release.

**RATINGS RATIONALE**

**--- DOWNGRADE REFLECTS RECENT WEAK PERFORMANCE AND CONTINUED ASSET QUALITY PROBLEMS IN CEE**

Moody's considers that the positioning of Erste's BCA at the ba1 level better reflects the ongoing trend of weakening pre-provision profits paired with high credit risk costs and a persistently elevated level of NPLs. Erste's earnings strength has weakened in recent years while the bank's capital generation capacity remains constrained by high risk charges and one off payments. In July this year, Erste increased its full year expectation for loan loss provisions to EUR2.4 billion, from EUR1.7 billion previously. The bank now expects a full year net loss of EUR1.4-1.6 billion, also as a result of a write-down on intangibles in Romania and deferred tax assets of up to EUR1.0 billion that does not impact regulatory capital.

While Moody's believes that Erste's NPLs start to stabilise at an elevated level (NPLs account for 9.4% on its total loan book and 14.1% of its gross loans in CEE), the ratings agency views the bank to remain vulnerable to a slow-down in economic activity in Eastern Europe, particularly because of reported very high NPL ratios in three of its five core markets in CEE: Romania (29.3%), Hungary (26.4%) and Croatia (18.3%).

**--- IMPROVED CAPITAL POSITION**

At a reported Common Equity Tier 1 (CET1) of 11.7% as of 30 June 2014 and guidance of a fully phased-in CET1 of about 10% as per year-end 2014, Moody's considers Erste's capital position to be adequate to absorb losses in a downside scenario, also given Erste's improved coverage ratio. A combination of a capital increase and a reduction in risk-weighted assets enabled Erste to repay its entire participation capital in 2013, thereby improving its capital quality without negatively affecting its capital ratio. Because of limited adjustments implied by the transitioning to the full implementation of Basel III, the rating agency considers the bank's capital position to be in line with similarly rated peers.

## RATIONALE FOR THE OUTLOOKS

The stable outlook on Erste's BFSR captures Moody's expectation of no further additional risk charges that would hamper the bank's future capital generation capacity. At the same time, the standalone credit profile -- as reflected in the BFSR/BCA positioning at D+/ba1 -- already captures substantial stress on the bank's exposures in CEE.

The negative outlook on Erste's long-term deposit and debt ratings reflects the recent adoption of the BRRD and the SRM regulation in the EU, which has shifted the balance of risk for banks' senior unsecured creditors to the downside as indicated by Moody's rating action on European banks of 29 May 2014.

### WHAT COULD CHANGE THE RATING - DOWN

Downward pressure could be exerted on Erste's D+ standalone BFSR following (1) further additional credit charges, in particular related to the bank's operations in CEE; (2) further weakening earnings that result in lower internal capital generation; and (3) weakened capitalisation levels as a result of accelerated credit losses or strong asset growth in CEE.

Downward pressure could be exerted on Erste's long-term ratings as a result of (1) a lowering of its own standalone ba1 BCA; or (2) a re-assessment of Moody's systemic support assumptions.

### WHAT COULD CHANGE THE RATING - UP

There is currently no upward rating pressure as reflected by the negative outlook.

Upward pressure on Erste's D+ standalone BFSR would be prompted by (1) a significant and sustained reduction in the volume of NPLs; and (2) sustained improvement in the bank's operating performance and its capital generation capacity.

### LIST OF AFFECTED RATINGS

The following ratings of Erste Group Bank AG were downgraded:

- Long-term senior unsecured debt and deposit ratings to Baa2 negative, from Baa1 negative;
- Subordinate and senior subordinate debt ratings to Ba2 stable, from Ba1 negative;
- Junior subordinate debt ratings to B1 (hyb) stable, from Ba3 (hyb) negative.

The following ratings of Erste Group Bank AG were affirmed:

- Short-term debt and deposit rating at Prime-2;
- D+ BFSR, now stable and mapping to a BCA of ba1, from previously negative and mapping to a BCA of baa3.

The following ratings of Erste Capital Finance (Jersey) Tier I PC were downgraded:

- Non-cumulative preferred securities to B1 (hyb) stable, from Ba3 (hyb) negative.

The following ratings of Erste Finance Jersey (4) Limited, Erste Finance Jersey (5) Limited, and Erste Finance Jersey (6) Limited were downgraded:

- Backed non-cumulative preferred securities to B1 (hyb) stable, from Ba3 (hyb) negative.

The following ratings of Erste Finance (Delaware) LLC were affirmed:

- Backed Commercial Paper at Prime-2.

The following ratings of Erste Bank, New York, were downgraded:

- Bank deposit ratings to Baa2 negative, from Baa1 negative.

### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Banks published in July 2014. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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