MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 December 2016

Update

Rate this Research

RATINGS

Erste Group Bank AG

Domicile	Vienna, Austria
Long Term Debt	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Analyst Contacts

Michael Rohr 49-69-70730-901
VP-Senior Credit Officer
michael.rohr@moodys.com

Alexander Hendricks, CFA 49-69-70730-779
Associate Managing Director - Banking
alexander.hendricks@moodys.com

Carola Schuler 49-69-70730-766
Managing Director - Banking
carola.schuler@moodys.com

Erste Group Bank AG

Semiannual update

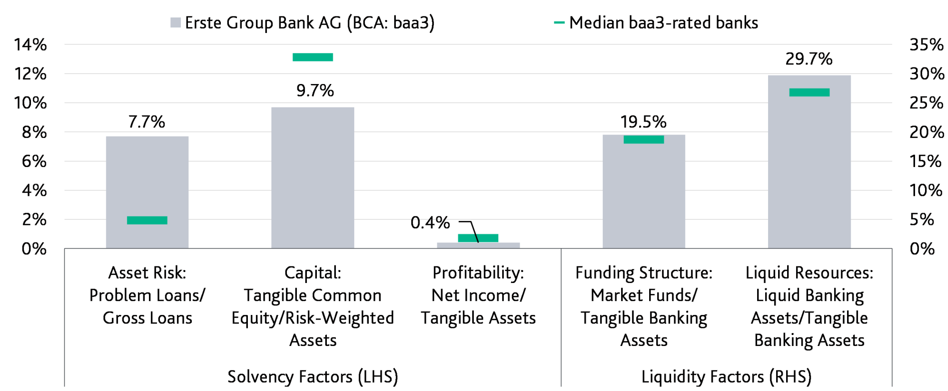
Summary Rating Rationale

We assign Baa1/P-2 senior unsecured debt and deposit ratings with a stable outlook to Erste Group Bank AG (Erste). Furthermore, we assign subordinated debt ratings of Ba1, a baa3 baseline credit assessment (BCA) and Adjusted BCA, and a Counterparty Risk (CR) Assessment of A3(cr)/P-2(cr) to Erste.

Erste's senior unsecured debt and deposit ratings reflect (1) the bank's baa3 BCA and Adjusted BCA; and (2) the result of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution and which results in two notches of rating uplift to Erste's long-term ratings.

Erste's baa3 BCA reflects (1) its successful and continued de-risking of its balance sheet through continued problem loan sales, thus leading to meaningfully lower risk costs; (2) the continued build-up of the bank's capital ratios; and (3) Erste having returned to its long-term earnings potential. The BCA also takes into account the bank's leading retail and corporate franchises throughout Austria and more mature economies in Central and Eastern Europe.

Exhibit 1
Rating Scorecard Erste Group Bank AG - Key Financial Ratios



Source: Moody's Financial Metrics; Note: Our definition of Tangible Common Equity (TCE) excludes domestic minority shares that are recognized as part of regulatory capital.

The ratings for the Additional Tier 1 securities and the Additional Tier 1 note program mentioned in this report were initiated by Moody's and were not requested by the rated entity.

Credit Strengths

- Successful management of significant problem loan reduction in Central and Eastern Europe (CEE)
- Strong recovery of the bank's earnings-generation capacity, despite pressure on earnings from the persistent low interest-rate environment and regulatory contributions
- Deposit-rich balance sheet with moderate reliance on wholesale funding

Credit Challenges

- Building additional buffers of loss-absorbing instruments
- Further credit quality improvement and maintenance of prudent lending standards despite earnings pressure
- Profitability challenged by low interest-rate environment and still high regulatory costs

Rating Outlook

- The stable outlook on Erste's long-term senior debt and deposit ratings reflects our expectation that Erste will be able to maintain its restored earnings generation capacity in the medium term.

Factors that Could Lead to an Upgrade

- Erste's ratings could be upgraded because of: (1) an upgrade of its BCA; and/or (2) an increase in subordinated debt volumes.
- Upward pressure on Erste's baa3 BCA would be prompted by (1) a further significant and sustained reduction in the volume of problem loans; (2) a sustained and further improvement in its capitalisation metrics; and (3) a further improvement in the bank's operating performance and capital-generation capacity from levels achieved in 2015 and 2016. In addition, an upgrade would require the bank to maintain its meanwhile solid risk management and corporate governance track record.
- Upward rating pressure on the bank's debt and deposit ratings would also develop if the bank increases the amount of subordinated debt that could be bailed in ahead of senior unsecured debt, providing one additional notch of rating uplift from our LGF analysis.

Factors that Could Lead to a Downgrade

- Downward pressure could be exerted on Erste's long-term ratings as a result of: (1) a downgrade of its baa3 BCA; or (2) a significant decrease in its bail-inable debt cushion, leading to fewer notches of rating uplift as a result of our LGF analysis.
- Downward pressure on Erste's baa3 BCA could be exerted following: (1) a renewed and sustained formation of problem loans and related loan loss charges, in particular if stemming from the bank's operations in CEE; (2) a sustained weakening in the bank's earnings- and thus capital-generation capacity; and (3) a weakening of the bank's recently improved capitalisation levels.

Key Indicators

Exhibit 2

Erste Group Bank AG (Consolidated Financials) [1]

	9-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (EUR billion)	203.4	194.8	187.6	192.6	202.3	0.1[4]
Total Assets (USD billion)	228.6	211.7	227.0	265.4	266.7	-3.8[4]
Tangible Common Equity (EUR billion)	9.8	8.8	7.8	8.8	8.1	5.1[4]
Tangible Common Equity (USD billion)	11.0	9.6	9.5	12.1	10.6	1.0[4]
Problem Loans / Gross Loans (%)	5.5	7.1	8.5	9.6	9.2	8.0[5]
Tangible Common Equity / Risk Weighted Assets (%)	9.7	9.0	7.8	9.0	7.6	8.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	49.5	62.7	71.0	74.3	77.1	66.9[5]
Net Interest Margin (%)	2.2	2.3	2.3	2.3	2.5	2.3[5]
PPI / Average RWA (%)	2.4	2.6	2.4	2.6	2.7	2.5[6]
Net Income / Tangible Assets (%)	0.9	0.6	-0.3	0.3	0.4	0.4[5]
Cost / Income Ratio (%)	64.3	61.3	65.6	62.3	58.8	62.4[5]
Market Funds / Tangible Banking Assets (%)	18.5	19.5	21.1	22.9	24.3	21.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	30.5	29.7	30.1	31.3	23.3	29.0[5]
Gross loans / Due to customers (%)	100.0	103.2	105.0	104.7	107.2	104.0[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

Detailed Rating Considerations

Successful and proactive reduction in the bank's CEE problem loans

Erste succeeded in reducing its problem loan or non-performing loan (NPL) ratio to 5.5% as of 30 September 2016 from its peak of 9.7% as of 30 June 2013 and improved its coverage ratio to 64.5% from 61.7% as of the same dates. As of end-September 2016, problem loans were €7.8 billion, down from €12.6 billion in June 2013, helped by portfolio sales particularly in Romania and Hungary. We expect the problem loan ratio to drop further if the bank is able to continue with its portfolio sales and maintains tight control of any potential new problem loan formation.

For the first nine months of 2016, Erste reported risk costs of €63.2 million or 11 basis points on its exposures. While the result compares very favourably against the bank's 2015 loan loss provisions of €729 million, or 56 basis points on its exposures (excluding additional charges for the bank's Swiss-franc denominated loan exposures in Croatia of €129.5 million), we do not view this level as sustainable going forward.

Key drivers of Erste's still slightly elevated NPL ratio are Romania, Hungary and Croatia, each displaying a problem loan ratio of around 13% as of 30 September 2016. At the same time, Erste reports good asset quality and adequate coverage in the Czech Republic and Slovakia, with problem loan ratios between 3.3% and 5.2%, respectively. Together, these two countries account for more than 60% of the bank's gross loans in CEE. Additional NPL sales should help the bank to further meaningfully decrease its stock of NPLs in Hungary, and additional NPL sales in Romania, Croatia and Slovakia would support this trend.

In addition to the risk of an overall economic slowdown in Europe, Erste also remains vulnerable to idiosyncratic developments in single countries, as experienced in Romania, Hungary and Croatia in recent years. Charges for the Romanian operations booked in 2014 showed significant short-comings in the bank's controls when integrating Banca Comerciala Romana S.A. (Ba1 positive, b2[1]). Developments in Hungary were driven by an adverse political environment to which Erste Bank Hungary Zrt. (Ba2 positive, b3[2]) was more exposed than competitors given their more aggressive lending policies in Swiss francs. For Croatia, the downside risk resulted from the forced conversion of Swiss-franc loans for retail and corporate clients that triggered significant P&L charges in the third quarter of 2015. However, as charges have been booked against the P&L in prior years, we believe the burden of these politically-driven measured to lie behind Erste.

Strong recovery of the bank's earnings-generation capacity, despite pressure on earnings from the persistent low interest-rate environment and regulatory contributions

Based on Erste's strong performance in the first nine months of 2016 following an already strong 2015, we consider the bank has regained its full earnings-generation capacity. Going forward, the bank will primarily be subject to net interest margin and thus earnings pressures from the persistently low interest-rate environment as loans and liquid financial investments re-price into lower rates. In addition, domestic and foreign bank levies, as well as contributions to various resolution funds and deposit guarantee schemes have increased the bank's regulatory expenses over the last years. Given the Austrian government's decision to reduce the domestic bank levy following a one-off payment in 2016, we expect this burden to be substantially reduced in 2017. Consequently, we also expect that Erste will be able to sustain its announced bottom-line profitability for year-end 2016 and potentially beyond, which is largely reflected in our assigned ba1 Profitability score.

As of 30 September 2016, Erste reported a 54% year-over-year growth in its bottom-line profitability (after minorities) to €1,179 million, supported by significantly reduced net risk costs and stable core operating earnings. The bank's operations in the Czech Republic and Slovakia accounted for 50% of the group's operating profits whilst Romania recovered and contributed a further 19% during the first nine months of 2016. Each of the bank's operations in CEE was able to contribute positively to the result, a meaningful achievement if compared with prior years' periods.

Erste's higher capital buffers position it well to meet regulatory requirements, but the bank needs to ensure continued scrutiny on its capital retention policy

We assign a Capital score of baa2 (three notches above the macro-adjusted score), which deliberately includes minority interests. Our positive adjustment captures the determination of Erste's CET1 ratio on a consolidated basis, reflective of the regulatory approval of the bank's joint liability scheme with the savings banks. This allows Erste to report its capitalisation without any reduction for its domestic minority shares.

With a 12.7% common equity Tier 1 (CET1) ratio on a fully-loaded basis as of 30 September 2016 (13.2% on a transitional basis), we consider the improved capitalisation to be sufficient to cover the intrinsic risks of the bank's operating model, which is geared towards CEE. In addition, and with a 6.1% fully-loaded Basel III leverage ratio in the third quarter of 2016, leverage is not a constraint for Erste. At the achieved capital and profitability levels, we consider the bank to be well prepared to comply with upcoming regulatory requirements, specifically with regard to the implementation of a systemic risk buffer by the Austrian regulator (25 basis points, effective since the beginning of 2016) and the currently anticipated fully-loaded 2019 CET1 ratio minimum requirement of 11.5% as set by the European Central Bank as part of its Supervisory Review and Evaluation Process (SREP).

Deposit-rich balance sheet with moderate reliance on wholesale funding

The bank's overall Combined Liquidity score of baa2 reflects Erste's balanced funding profile and its significant reduction in wholesale funding dependence.

Erste's funding structure continues to be a relative strength, with a sustained loan-to-deposit ratio at or below 100% over the past few years (30 September 2016: 96.2%, year-end 2015: 98.4%). The bank continues to benefit from its access to a broad and diversified base of customer deposits, accounting for more than two thirds of total liabilities. Approximately 55% of the bank's customer deposits are generated from its domestic Austrian operations, with the remaining portion being CEE-related deposits (albeit concentrated in the Czech Republic and Slovakia). Our baa1 Funding Structure score further reflects the high granularity of Erste's deposit base, mainly relying on deposits from retail investors and small- and medium-sized enterprises.

Erste's liquidity position is comfortable. The bank's outstanding debt securities account for around 15% of total liabilities, of which covered bonds represented approximately 33% (€9.1 billion). We estimate Erste's annual long-term refinancing needs to be approximately €2.5 billion for the next three years, which is manageable compared with the bank's balance sheet size. Erste's market funding profile further benefits from an average debt maturity of approximately eight years.

These considerations also take into account the Austrian regulator's recommendation that the country's three major banks limit their new lending in CEE subsidiaries to 110% of local deposits, plus funding in local capital markets and funding from supranational institutions. This more locally-based funding model mitigates potential risks resulting from possible funding imbalances in local markets, and Erste displayed a sound profile as of Q3 2016 with deposits exceeding loans for Erste's larger CEE franchises.

Notching Considerations

Loss Given Failure Analysis

Erste is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider an Operational Resolution Regime. We therefore apply our Advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution. In-line with our standard assumptions, we assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt.

For Erste's senior unsecured debt and deposits, our LGF analysis indicates a very low loss-given-failure, leading to two notches of rating uplift from the bank's baa3 Adjusted BCA.

Additional notching for subordinated and hybrid debt instruments

For other junior debt classes, our Advanced LGF analysis indicates a high loss-given-failure, given the limited volume of debt and limited protection from more subordinated instruments and residual equity. Absent any government support uplift, Erste's subordinated debt is therefore rated Ba1, one notch below the bank's baa3 Adjusted BCA.

Additional notching applies to Erste's junior subordinated debt instruments reflecting the risk of a missed coupon payment and the timeliness of those payments:

1) Erste's non-cumulative junior subordinated debt maturing in February 2017 (ISIN: XS0143383148, Moody's Debt ID: 323181) is rated Ba3(hyb), three notches below the bank's baa3 Adjusted BCA. The rating reflects our assessment of the instrument's junior subordinated claim in liquidation and non-cumulative deferral features tied to the breach of a net loss trigger.

2) Erste's cumulative junior subordinated debt maturing in June 2019 (ISIN: XS0303559115, Moody's Debt ID: 820418491) is rated Ba2(hyb), two notches below the bank's baa3 Adjusted BCA. The rating reflects the junior subordinated claim in liquidation and cumulative deferral features tied to the breach of a net loss trigger.

Additional Tier 1 (AT1) Instruments

We assign an unsolicited (P)Ba3 rating to Erste's AT1 note program and an unsolicited Ba3(hyb) rating to the €500 million AT1 notes issued under the program, three notches below the bank's baa3 Adjusted BCA. These ratings were not initiated at the request of the rated entity.

The ratings reflect our assessment of the instrument's deeply subordinated claim in liquidation as well as its non-cumulative coupon deferral features. In addition, the securities' principal is subject to a partial or full write-down on a contractual basis if: (1) Erste's CET1 ratio falls below 5.125%; or (2) the issuer receives public support; and/or (3) the Austrian Financial Market Authority (FMA) determines that the conditions for a full write-down of the instrument are fulfilled and orders such a write-down as a measure to prevent insolvency.

Government Support

The wider scope of the BRRD implementation in Austria and its recent application, triggering a resolution of Heta Asset Resolution AG (Ca, stable[3]), illustrates the Austrian government's willingness to apply burden-sharing to bondholders. We have therefore eliminated government support from our Austrian banks ratings, assuming a low probability of Erste receiving support from the Austrian government.

Rating Methodology and Scorecard Factors

Exhibit 3

Erste Group Bank AG

Macro Factors		
Weighted Macro Profile	**Strong -**	**100%**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.7%	ba2	↑	ba1	Quality of assets	Expected trend
Capital						
TCE / RWA	9.7%	ba2	←→	baa2	Capital fungibility	
Profitability						
Net Income / Tangible Assets	0.4%	ba3	←→	ba1	Expected trend	
Combined Solvency Score		ba2		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	19.5%	baa2	←→	baa1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.7%	baa2	←→	baa3	Asset encumbrance	
Combined Liquidity Score		baa2		baa2		
Financial Profile				baa3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa1		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

Balance Sheet	**in-scope (EUR million)**	**% in-scope**	**at-failure (EUR million)**	**% at-failure**
Other liabilities	47,536	33.0%	55,040	38.2%
Deposits	73,561	51.1%	66,058	45.9%
Preferred deposits	54,435	37.8%	51,713	35.9%
Junior Deposits	19,126	13.3%	14,344	10.0%
Senior unsecured bank debt	11,815	8.2%	11,815	8.2%
Dated subordinated bank debt	5,893	4.1%	5,893	4.1%
Preference shares (bank)	830	0.6%	830	0.6%
Equity	4,319	3.0%	4,319	3.0%
Total Tangible Banking Assets	143,954	100%	143,954	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	25.8%	25.8%	25.8%	25.8%	3	3	3	3	0	a3 (cr)
Deposits	25.8%	7.7%	25.8%	15.9%	2	3	2	2	0	baa1
Senior unsecured bank debt	25.8%	7.7%	15.9%	7.7%	2	2	2	2	0	baa1
Dated subordinated bank debt	7.7%	3.6%	7.7%	3.6%	-1	-1	-1	-1	0	ba1
Junior subordinated bank debt	3.6%	3.6%	3.6%	3.6%	-1	-1	-1	-1	-2	ba3 (hyb)
Non-cumulative bank preference shares	3.6%	3.0%	3.6%	3.0%	-1	-1	-1	-1	-2	ba3 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a3 (cr)	0	A3 (cr)	--
Deposits	2	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	2	0	baa1	0	Baa1	Baa1
Dated subordinated bank debt	-1	0	ba1	0	Ba1	--
Junior subordinated bank debt	-1	-2	ba3 (hyb)	0	Ba3 (hyb)	--
Non-cumulative bank preference shares	-1	-2	ba3 (hyb)	0	Ba3 (hyb)	--

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
ERSTE GROUP BANK AG	
Outlook	Stable
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Senior Unsecured	Baa1
Senior Subordinate -Dom Curr	Ba1
Jr Subordinate -Dom Curr	Ba3 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Ba3 (hyb)
Commercial Paper -Dom Curr	P-2
Other Short Term -Dom Curr	(P)P-2
CESKA SPORITELNA, A.S.	
Outlook	Stable
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
ERSTE BANK HUNGARY ZRT.	
Outlook	Positive
Bank Deposits	Ba2/NP
Baseline Credit Assessment	b3
Adjusted Baseline Credit Assessment	b1
Counterparty Risk Assessment	Ba1(cr)/NP(cr)
ERSTE BANK, NEW YORK	
Outlook	Stable
Bank Deposits	Baa1/--
Counterparty Risk Assessment	A3(cr)/P-2(cr)
ERSTE FINANCE (DELAWARE) LLC	
Bkd Commercial Paper	P-2
BANCA COMERCIALA ROMANA S.A.	
Outlook	Positive
Bank Deposits	Ba1/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	ba3
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)

Source: Moody's Investors Service

Endnotes

1 The ratings shown in this report are the bank's deposit rating and outlook as well as its BCA.

2 The ratings shown in this report are the bank's deposit rating and outlook as well as its BCA.

3 The ratings shown in this report are the bank's backed senior unsecured debt rating and outlook.

REPORT NUMBER 1052600

Contributors

Torsten-Alexander Thebes
Associate Analyst

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454