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CREDIT OPINION
22 May 2017

Update

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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.

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Erste Group Bank AG

Semiannual update

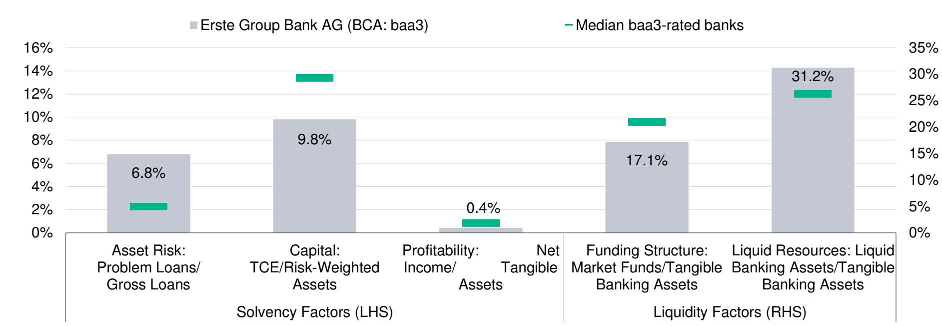
Summary Rating Rationale

We assign Baa1/P-2 senior unsecured debt and deposit ratings with a stable outlook to Erste Group Bank AG (Erste). Furthermore, we assign 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 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 ratings.

Erste's baa3 BCA reflects (1) the successful de-risking of its balance sheet through problem loan sales, leading to meaningfully lower risk costs; (2) the build-up of the bank's capital ratios to a sustained higher level; 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 (CEE).

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.

Credit Strengths

» Significantly improved asset quality following successful problem loan reduction in CEE

» Solid earnings-generation capacity, despite pressure on earnings from the persistently low interest-rate environment and regulatory contributions

» Deposit-rich and highly-liquid balance sheet with moderate reliance on wholesale funding

Credit Challenges

» Further improve capitalisation levels and build additional buffers of loss-absorbing instruments

» Maintain prudent lending standards despite earnings pressure and resurfacing growth opportunities in CEE

Rating Outlook

» The stable outlook on Erste's ratings reflects our expectation of stable asset quality, capital and profitability metrics over the next 12-18 months.

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 sustained reduction in the volume of problem loans; (2) a further improvement in its capitalisation metrics; and (3) a continued stabilisation of the bank's operating performance and capital-generation capacity from levels achieved in 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 further 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 CEE operations; (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]

	12-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (EUR billion)	203	195	188	193	202	0.1[4]
Total Assets (USD billion)	214	212	227	265	267	-5.3[4]
Tangible Common Equity (EUR billion)	10	8.9	7.8	8.8	8.1	5.5[4]
Tangible Common Equity (USD billion)	10	9.6	9.5	12	11	-0.2[4]
Problem Loans / Gross Loans (%)	4.9	7.1	8.5	9.6	9.2	7.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	9.8	9.0	7.8	9.0	7.6	8.9[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	45.7	62.6	71.0	74.3	77.1	66.1[5]
Net Interest Margin (%)	2.2	2.3	2.3	2.3	2.5	2.3[5]
PPI / Average RWA (%)	2.2	2.6	2.4	2.6	2.7	2.4[6]
Net Income / Tangible Assets (%)	0.7	0.6	-0.3	0.3	0.4	0.3[5]
Cost / Income Ratio (%)	67.1	61.3	65.6	62.3	58.8	63.0[5]
Market Funds / Tangible Banking Assets (%)	17.1	19.4	21.1	22.9	24.3	20.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	31.2	29.7	30.1	31.3	23.3	29.1[5]
Gross Loans / Due to Customers (%)	98.1	103.2	105.0	104.7	107.2	103.6[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 (%). Any interim period amounts presented are assumed to be fiscal year end amounts for calculation purposes [5] Simple average of periods presented [6] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Detailed Rating Considerations

Significantly improved asset quality following successful problem loan reduction in CEE

Following the successful reduction of problem loan exposures in CEE, we view Erste's year-end 2016 problem loan ratio of 4.9% as sustainable going forward. This was further confirmed by Erste reporting a stable Q1 2017 problem loan ratio of 4.9%, significantly below its peak level of 9.7% as of 30 June 2013. The coverage ratio improved to 66.5% from 61.7% as of the same dates.

As of end-2016, problem loans were €6.7 billion, down from €12.6 billion in June 2013, helped by €1.6 billion of portfolio sales during 2016, particularly in Romania, Hungary and Croatia. In these three countries, problem loan ratios remained at elevated levels, ranging from 10-12% as of 31 December 2016. At the same time, Erste reports good asset quality and solid coverage in its home market Austria (excluding other Austria), as well as the Czech Republic and Slovakia. Together, the Czech Republic and Slovakia account for more than 60% of the bank's gross loans in CEE and displayed problem loan ratios of 3.2% and 4.5%, respectively. We have reflected these improvements in assigning a baa3 Asset Risk score to Erste.

During 2016 as well as the first quarter of 2017, Erste's risk costs remained near historically low levels (Q1 2017: 19 basis points; 2016: 14 basis points). Medium-term, we anticipate loan loss charges to rise from current levels. In addition to the risk of an overall economic slowdown in CEE leading to higher risk charges, Erste also remains vulnerable to idiosyncratic developments in single countries. However, as charges have been booked against the P&L in prior years, we believe the burden of these often politically-driven measures (e.g. foreign-currency denominated loans in Hungary, Croatia and Romania) to lie behind Erste.

Solid earnings-generation capacity, despite pressure on earnings from the persistent low interest-rate environment and regulatory contributions

Having regained its full earnings-generation capacity, Erste 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 reprice 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 2017 and potentially beyond, which is largely reflected in our assigned ba1 Profitability score.

As of 31 December 2016, Erste reported a 31% year-over-year growth in its bottom-line profitability (after minorities) to €1,265 million, supported by significantly reduced net risk costs (down an absolute €533 million year-over-year) and stable core operating earnings. The bank's operations in the Czech Republic and Slovakia accounted for 49% of the group's pre-tax profits whilst Romania recovered and contributed a further 12% during 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.

Deposit-rich and highly-liquid 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 continued reduction in wholesale funding dependence. Erste's funding structure continues to be a relative strength, with a sustained loan-to-deposit ratio of below 100% over the past few years (Q1 2017: 91.9%; 2016: 94.7%; 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 baa2 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 13% of total liabilities, of which covered bonds represented approximately one-third (€9.3 billion). We estimate Erste's annual long-term refinancing needs to be approximately €2.5 billion for the next two years, which is manageable compared with the bank's balance sheet size of €208 billion as of year-end 2016 (Q1 2017: €223 billion). 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 end-2016 with deposits exceeding loans for all of Erste's larger CEE franchises.

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 12.8% common equity Tier 1 (CET1) ratio on a fully-loaded basis as of end-2016, 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 6.2% fully-loaded Basel III leverage ratio, balance-sheet leverage is not a constraint for Erste. At the achieved capital and profitability levels, the bank is well prepared to comply with upcoming regulatory requirements, specifically with regard to the implementation of a systemic risk buffer by the Austrian regulator (50 basis points, effective since the beginning of 2017 and growing to 200 basis points by 2019) and the currently anticipated fully-loaded 2019 CET1 ratio minimum requirement of 10.9% (excluding Pillar 2 CET1 Guidance of 1.66% as of 2017) as set by the European Central Bank as part of its Supervisory Review and Evaluation Process (SREP).

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. Erste's cumulative junior subordinated debt maturing in June 2019 (ISIN: XS0303559115, Moody's Debt ID: 820418491) is therefore rated Ba2(hyb), two notches below the bank's baa3 Adjusted BCA. This 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 two €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 instruments' 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[1]), 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%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	6.8%	ba2	←→	baa3	Quality of assets	Expected trend
Capital						
TCE / RWA	9.8%	ba2	←→	baa2	Capital fungibility	
Profitability						
Net Income / Tangible Assets	0.4%	ba3	←→	ba1	Return on assets	Expected trend
Combined Solvency Score		ba2		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	17.1%	baa2	←→	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	31.2%	a3	←→	baa2	Asset encumbrance	
Combined Liquidity Score		baa1		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	43,190	30.4%	50,922	35.8%
Deposits	75,811	53.3%	68,078	47.8%
Preferred deposits	56,100	39.4%	53,295	37.5%
Junior Deposits	19,711	13.9%	14,783	10.4%
Senior unsecured bank debt	11,916	8.4%	11,916	8.4%
Dated subordinated bank debt	6,078	4.3%	6,078	4.3%
Junior subordinated bank debt	20	0.0%	20	0.0%
Preference shares (bank)	1,000	0.7%	1,000	0.7%
Equity	4,269	3.0%	4,269	3.0%
Total Tangible Banking Assets	142,283	100%	142,283	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	26.8%	26.8%	26.8%	26.8%	3	3	3	3	0	a3 (cr)
Deposits	26.8%	8.0%	26.8%	16.4%	2	3	2	2	0	baa1
Senior unsecured bank debt	26.8%	8.0%	16.4%	8.0%	2	2	2	2	0	baa1
Dated subordinated bank debt	8.0%	3.7%	8.0%	3.7%	-1	-1	-1	-1	0	ba1
Junior subordinated bank debt	3.7%	3.7%	3.7%	3.7%	-1	-1	-1	-1	-1	ba2 (hyb)
Non-cumulative bank preference shares	3.7%	3.0%	3.7%	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	-1	ba2 (hyb)	0	Ba2 (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	Ba2 (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 backed senior unsecured debt rating and outlook.

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