

### Research Update:

# Austria-Based Erste Group Bank AG 'A' Rating Affirmed On High Systemic Importance; Outlook Negative

#### Primary Credit Analyst:

Volker von Kruechten, Frankfurt (49) 69-33-999-164; volker\_vonkruechten@standardandpoors.com

#### Secondary Credit Analysts:

Elena Romanova, Moscow (7) 495-783-40-91; elena\_romanova@standardandpoors.com

Markus Schmaus, Frankfurt (49) 69-33-999-155; markus\_schmaus@standardandpoors.com

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## Research Update:

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## Overview

- In our view, Erste Group Bank remains highly systemically important to Austria, and we incorporate one notch of implicit government support instead of two notches previously.
- We believe that Erste Group Bank's strengthened ability to withstand deteriorated business conditions, as a result of capital measures and better-than-expected operating performance before risk, improves its stand-alone credit profile.
- We are affirming our 'A/A-1' long- and short-term ratings on Erste Group Bank.
- The negative outlook reflects the challenging environment in Erste Group Bank's key markets and our assessment that implicit government support--ultimately viewed as temporary--might prove insufficient in a stress scenario.

## Rating Action

On Dec. 10, 2009, Standard & Poor's Ratings Services affirmed its 'A' long-term and 'A-1' short-term counterparty credit ratings on Austria-based Erste Group Bank AG (Erste). The outlook is negative.

## Rationale

The rating affirmation reflects our view of Erste as a highly systemically important institution to Austria, which would likely continue to receive extraordinary government support in case of need. It also reflects that government support, through the injection of participation capital and access to the issuance of state-guaranteed debt, has improved Erste's stand-alone credit profile. Furthermore, we believe that Erste has strengthened its ability to withstand deteriorated business conditions, thanks to a recent capital increase by shareholders and a better-than-expected operating performance before risk in 2009. Consequently, the long-term ratings on Erste now include one notch--instead of two notches previously--of implicit government support, reflecting our assessment of Erste's improved stand-alone credit strength and our expectation that preprovision earnings will remain sufficient to absorb rising loan loss provisions.

The ratings continue to be based on our view of Erste and the Austrian savings banks as a single economic group and on the group's prominent market position

in Austria and Central and Eastern Europe (CEE). They also reflect Erste's sound funding and liquidity standing, in our view. Factors constraining the ratings are weak earnings prospects after risk, based on our expectation of significantly weaker asset quality. Despite recent improvements, we regard Erste's capital strength as still moderate in light of considerable uncertainties about the duration and intensity of the economic downturn, particularly in CEE and to a lesser extent in Austria.

We expect high credit risk to be the key rating factor hampering Erste's financial performance in 2009-2011. The group's nonperforming loans increased to 6.3% on Sept. 30, 2009, up from 4.7% at year-end 2008, with much faster growth in CEE (up 6.7% from 3.8%). Although we expect new provisioning needs to peak in 2010, we believe risk costs in 2011 would still remain several times higher than those of 2007. However, owing to Erste's efficient asset repricing, in our view, and considerable cost reductions, particularly in CEE, we expect its operating profitability before risk to stay sufficiently high in our base case to cover risk costs throughout 2009-2011, without extra government support.

Erste's capitalization--a primary negative rating factor in recent years--has been significantly strengthened in 2009. A €1.74 billion increase of pure capital in November 2009 and a €1.76 billion injection of hybrid capital (€1.22 billion "Partizipationskapital" subscribed by the Austrian government and €0.54 billion from private investors) have raised the regulatory Tier 1 ratio by about three percentage points to about 10%. The core Tier 1 ratio, excluding hybrid instruments, increased to 7.8% from 5.2% during the same period. Nevertheless, we still regard Erste's capital strength and buffer against material adverse events to be comparatively moderate and below the average of major international banks, owing to our assessment of Erste's higher-risk CEE exposures.

## Outlook

The negative outlook reflects the challenging environment in the Erste group's key markets, which could lead to a significant deterioration of asset quality and further pressure on Erste's financial profile. Although we believe that further support from the state would be forthcoming if needed to avert systemic risk in the Austrian banking system, ultimately, we consider government support to be of a temporary nature.

We would consider negative rating actions if, contrary to our expectation, we perceive that the government is less willing to provide support, or if external support proved insufficient in a stress scenario in which Erste's still-satisfactory financial risk profile deteriorates more than we expect because of higher loan loss provisions or lower operating profitability before risk.

A positive rating action is unlikely in the short term because we would need to see a material and sustainable stabilization of economic conditions, both

in Austria and CEE, and higher contributions from Erste's Austrian operations.

## Related Research

- Credit Stress Testing For Financial Institutions, April 29, 2009
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

## Ratings List

### Ratings Affirmed

#### Erste Group Bank AG

Counterparty Credit Rating	A/Negative/A-1
Senior Unsecured	A
Subordinated	A-
Commercial Paper	A-1
Certificate Of Deposit	A/A-1

#### Erste Finance (Delaware) LLC

Commercial Paper	A-1
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### Additional Contact:

Financial Institutions Ratings Europe;FIG\_Europe@standardandpoors.com

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