STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

October 11, 2011

Research Update:

Austria-Based Erste Group Bank Outlook Revised To Negative On Mounting Credit Risks In Hungary; 'A/A-1' Ratings Affirmed

Primary Credit Analyst:
Pierre Gautier, Paris (33) 1-4420-6711;pierre_gautier@standardandpoors.com

Secondary Contact:
Markus Schmaus, Frankfurt (49) 69-33-999-155;markus_schmaus@standardandpoors.com

Table Of Contents

Research Update:

Austria-Based Erste Group Bank Outlook Revised To Negative On Mounting Credit Risks In Hungary; 'A/A-1' Ratings Affirmed

Overview

- Erste Group Bank announced on Oct. 10 that it will post a loss of €700 million-€800 million for 2011, partly because of nonoperating one-off items.
- More importantly from a credit perspective, the bank is facing rising credit risks stemming from its Hungarian portfolio.
- We are affirming our 'A/A-1' ratings on Erste.
- We are revising our assessment of the bank's stand-alone credit profile (SACP) to 'bbb+' from 'a-', reflecting our view that its financial profile is weakening.
- We're revising the outlook to negative, reflecting the risks of additional losses coming from Hungarian operations in 2012 and the challenge Erste is facing to build up capital amid deteriorating economic conditions throughout Europe.

Rating Action

On Oct. 11, 2011, Standard & Poor's Ratings Services revised the outlook on Austria-based Erste Group Bank AG to negative from stable. We affirmed our 'A/A-1' long- and short-term counterparty credit ratings on Erste. At the same time, we revised our stand-alone credit profile (SACP) on the bank to 'bbb+' from 'a-'. In addition, we revised our outlook on Czech-based Ceska Sporitelna A.S. (CS) to negative from stable given its core status to Erste. We also affirmed our 'A/A-1' ratings on CS. We do not use outlooks for public information (pi) ratings, so the 'Api' rating on core Slovak-based subsidiary Slovenska Sporitelna A.S. is unchanged.

Rationale

The outlook revision to negative reflects the risk of Erste's financial profile deteriorating as a result of the weakening operating conditions in Hungary (BBB-/Negative/A-3) and the delayed economic recovery in Romania (foreign currency: BB+/Stable/B, local currency: BBB-/Stable/A-3). Hungary and Romania together accounted for about 15% of Erste's exposure at default at year-end 2010.

We revised our SACP on Erste to 'bbb+' from 'a-'. We now incorporate in our long-term rating two notches of uplift above the SACP, reflecting Erste's status as a highly systemically important bank in a supportive country, Austria

(AAA/Stable/A-1+) and our expectation for extraordinary government support to be forthcoming if needed.

Erste announced on Oct. 10 that it will post a €700 million-€800 million loss for 2011. A large part of the loss is attributed to the write-off of €1 billion of goodwill from its Hungarian and Romanian subsidiaries. According to our criteria, we already deduct the goodwill from our definition of capital, so this large goodwill write-off does not affect our view of Erste's capital position. In addition, Erste will also incur losses following the reclassification and change in accounting treatment of its credit default swap (CDS) portfolio. We view these elements mainly as nonoperating one-off charges.

The deterioration of the operating conditions in Hungary, a country where Erste intends to create additional reserves worth €450 million to cover possible future losses, poses greater risk than the nonoperating one-off items, in our view, to the bank's creditworthiness. Many banks operating in Hungary, including Erste, will likely suffer increasing losses as a result of the Hungarian government's decision to allow individual borrowers to repay their mortgages in Swiss francs at a fixed parity with the Hungarian forint, a parity which is more than 20% lower than the spot rate. A significant portion of Erste's mortgages in Hungary are denominated in Swiss francs, so we believe additional risks exist. As a result, Erste may need to build up additional reserves in 2012, beyond the €450 million already announced in 2011. This legislation-related pressure adds to the already challenging economic conditions in Hungary, where nonperforming loans were more than 15% of gross loans as of June 30, 2011, and likely will continue to increase through the second half of 2011.

The combination of these one-off items and the situation in Hungary will prevent Erste from strengthening its capital position in 2011, as we previously expected it would. We expect the bank to report a moderate 6% risk-adjusted capital (RAC) ratio at year-end 2011 (broadly unchanged from 2010). Similarly, Erste could find it difficult to restore its earnings to pre-crisis levels. In our view, at least in the next two years, Erste's financial profile could weaken, which explains why we have revised our SACP to 'bbb+' from 'a-'. We continue to believe that Erste would receive government support if needed, which mitigates the downward pressure that the SACP places on the long-term rating.

Outlook

The outlook is negative. It reflects the risk of an increase in risk losses, above the cumulative €3.1 billion to €3.8 billion we were expecting for 2011 and 2012. At the same time, the economic slowdown we expect throughout Europe could impede new business generation, even in Central and Eastern European countries that have been resilient so far, such as the Czech Republic and Slovak Republic, and constrain retained earnings, thereby reducing the buffer to absorb risks. We expect Erste to preserve a good funding profile and sound liquidity, and we don't expect yesterday's announcement to alter the bank's relatively strong business profile.

We could lower the rating if Erste is not able to strengthen its capital position in 2012 above current levels, either because prerisk operating profitability weakens amid less favorable economic conditions or because loan losses prove higher than we expected. We would view negatively any aggressive capital management, which would be detrimental to capital build-up. If these concerns do not materialize, we could revise the outlook back to stable.

A positive rating action is a remote scenario in the current economic context and would entail a stronger financial profile. This includes improving operating income--notably a higher contribution from the Austrian businesses, abating pressure on the Romanian and Hungarian portfolio--and a stable RAC ratio well above 7%. However, we view both elements as difficult to achieve over the next two years.

Related Criteria And Research

- Group Methodology, April 22, 2009
- Bank Rating Analysis Methodology Profile, March 18, 2004

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Erste Group Bank AG		
Ceska Sporitelna A.S.		
Counterparty Credit Rating	A/Negative/A-1	A/Stable/A-1
Certificate Of Deposit	A/A-1	
Slovenska Sporitelna A.S. (Unsolicited Ratings)		
Counterparty Credit Rating	Api/--/--	
Erste Group Bank AG		
Senior Unsecured	A	
Subordinated	A-	
Commercial Paper	A-1	
Erste Finance (Delaware) LLC		
Commercial Paper*	A-1	
*Guarantor: Erste Group Bank AG.		

Additional Contact:
Financial Institutions Ratings Europe;FIG_Europe@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.