

Research Update:

Austria-Based Erste Group Bank Ratings Affirmed On Solid Buffers, Outlook To Stable On Deepening COVID-19 Risks

April 29, 2020

Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Austria and others to which Erste Group is exposed, face an unprecedented challenge.
- While Erste Group's earnings and, to a lesser extent, capitalization could be weaker than we previously expected, we expect it to demonstrate superior resilience thanks to its solid business model, strong profitability, and financial buffers.
- We are therefore revising to stable from positive our outlook on Erste Group Bank AG (Erste) and its core subsidiary Ceska Sporitelna A.S. At the same time, we are affirming our long- and short-term issuer credit ratings at 'A/A-1'.
- The stable outlook reflects our expectation that Erste will manage the downside risks that it faces in the coming 12-24 months. This includes our opinion that economic risk for the Austrian banking system could increase in the medium term as a result of the COVID-19-related economy slowdown, and weakening operating conditions in Erste's core strategic Central and Eastern European (CEE) markets.

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Rating Action

On April 29, 2020, S&P Global Ratings revised to stable from positive the outlook on Erste Group Bank AG (Erste) and its core subsidiary Ceska Sporitelna A.S. At the same time, we affirmed the long- and short-term issuer credit ratings at 'A/A-1'. We also affirmed our resolution counterparty ratings on Erste and Ceska, and our issue ratings on Erste's hybrid instruments, including our 'A'-rating on the bank's senior subordinated debt.

Rationale

We believe that the cyclical downturn arising from the COVID-19 pandemic has led to a weakened economic and operating environment for Erste's main markets in Austria and its several core strategic countries in CEE. We have assigned a negative economic risk trend for our Banking Industry Country Risk Assessment (BICRA) for Austria because we believe the economic environment in Austria could eventually meaningfully deteriorate, particularly if the economic recovery is slower than we currently expect.

We acknowledge the considerable regulatory, central bank, and governmental fiscal and monetary policy packages to help workers and companies bridge the gap to recovery. We now expect the bank's earnings, asset quality, and capitalization to be weaker than we previously envisaged through end-2020 and into 2021. Nevertheless, we have affirmed the ratings because, even under our revised base case, we consider that Erste is well-positioned to weather this short-term cyclical downturn.

For the short term at least, the COVID-19 pandemic has led our economists to forecast a sharp economic contraction in the second quarter of 2020, followed by a rebound from the third quarter. However, we acknowledge a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Our economists are already cautious about the strength of recovery through end-2020 and into 2021, and we see risks to these projections as heavily skewed to the downside. Even under this base case, the effects of COVID-19 will be apparent in European banks' asset quality, revenues, profitability, liquidity, and, potentially, capitalization.

Similar to its broader European bank peer group, we now expect a material but manageable increase in Erste's loan-loss provisions and nonperforming assets in its core retail and corporate portfolio. We nevertheless expect Erste to demonstrate superior resilience, in large part due to its well-managed business model, its sound risk management, and its well-diversified business mix from its retail and SME focus. Its sound earnings also offer a significant buffer to absorb a spike in credit losses, indeed more so than for many leading European peers.

Like its peers, we expect very few of these negative profitability trends to play out in the bank's first-quarter results. However, they would likely become increasingly evident through 2020 and into 2021. As a result, we now project that our main capital indicator, our risk-adjusted capital (RAC) ratio, for Erste will mildly dilute to a still comfortable 9.0%-9.5% in the next 12-24 months. (In previous years it had been on a steady upward path and appeared that it might move beyond 10%.) Beyond the temporary implications of the effects of COVID-19 on the economic environment, we acknowledge management's continuing efforts to digitalize the bank, which will help safeguard the customer base against changing consumer preferences.

Outlook

The stable outlook reflects that Erste will manage the downside risks it faces in the coming 12-24 months. This includes our opinion that economic risk for the Austrian banking system could increase over the medium term as a result of the economic slowdown related to the pandemic, and weakening operating conditions in Erste's core strategic CEE markets.

Downside scenario

We could lower our ratings on Erste if we see a further deterioration in the operating environment,

leading to a more material setback to profitability and asset quality, particularly if the bank became loss-making. This would challenge our current view that Erste should demonstrate superior resilience in difficult markets.

Upside scenario

We could raise our ratings over the next 24 months if we saw sustainable improvements in global economic conditions including stable economic and industry risk trends for the Austrian banking industry and the main markets where Erste operates. At the same time, Erste would need to strengthen materially its RAC ratio, or we would need greater insight into the pace and size of its build-up of bail-inable capital buffers.

Ratings Score Snapshot

	To	From
Issuer Credit Ratings	A/Stable/A-1	A/Positive/A-1
Resolution Counterparty Ratings	A+/A-1	A+/A-1
SACP	a	a
Anchor	bbb+	bbb+
Business Position	Strong (+1)	Strong (+1)
Capital & Earnings	Adequate (0)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Above Average and Strong (+1)	Above Average and Strong (+1)
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional factors	0	0

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015

- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Outlook Revisions On Several Austrian Banks On Deepening COVID-19 Downside Risks, April 29, 2020
- How COVID-19 Risks Prompted European Bank Rating Actions, April 29, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers, April 1, 2020
- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- The Coronavirus Will Shave 50 Basis Points Off Eurozone Growth, March 4, 2020

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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