Segments

Erste Group's segment reporting is based on IFRS 8 Operating Segments, which adopts the management approach. Accordingly, segment information is prepared on the basis of internal management reporting that is regularly reviewed by the chief operating decision-maker to assess the performance of the segments and make decisions regarding the allocation of resources. Within Erste Group, the function of the chief operating decision-maker is exercised by the management board.

Erste Group's segment reporting is based on the matrix organisation (business and geographical information) and provides comprehensive information to assess the performance of the segments.

The tables and information in this section are not subject to the audit of the consolidated financial statements. They provide a brief overview and focus on selected and summarised items. For more details, please see Note 37. Additional information is available in Excel format at http://www.erstegroup.com/en/investors/reports/financial_reports.

Operating income consists of net interest income, net fee and commission income, net trading as well as result from financial assets and liabilities designated at fair value through profit or loss, dividend income, net result from equity method investments and rental income from investment properties & other operating leases. The latter four listed items are not separately disclosed in the tables below. Operating expenses equal the position general administrative expenses. Operating result is the net amount of operating income and operating expenses. Risk provisions for loans and receivables are included in the position net impairment loss on financial assets. Other result summarises the positions other operating result and gains/losses from financial assets and liabilities not measured at fair value through profit or loss. The cost/income ratio is calculated as operating expenses in relation to operating income. The return on allocated equity is defined as the net result after tax/before minorities in relation to the average allocated equity.

Business segments

Erste Group – business segments						
Retail	Corporates	Group Markets	Asset/Liability Management & Local Corporate Center	Savings Banks	Group Corporate Center	Intragroup Elimination

The **Retail** segment comprises the business with private individuals, micros and free professionals within the responsibility of account managers in the retail network. This business is operated by the local banks in cooperation with their subsidiaries such as leasing and asset management companies with a focus on simple products ranging from mortgage and consumer loans, investment products, current accounts, savings products to credit cards and cross selling products such as leasing, insurance and building society products.

The **Corporates** segment comprises business activities with corporate customers of different turnovers (small and medium-sized enterprises, Local Large Corporate and Group Large Corporate customers) as well as commercial real estate and public sector business. Small and medium-sized enterprises (SME) are customers under the responsibility of the local corporate commercial center network with annual turnover up to determined thresholds. Local Large Corporates (LLC) are customers with an annual turnover exceeding the SME thresholds but not categorised as Group Large Corporate customers. Group Large Corporates (GLC) are large corporate customers/client groups with substantial operations in Erste Group's core markets that are included in the GLC client list. Commercial Real Estate (CRE) includes for example business with real estate investors generating income from the rental of individual properties or portfolios of properties as well as with developers of individual properties or portfolios of properties generating capital gains through sale. Public Sector consists of three sets of customers: public sector, public corporations and non-profit sector.

The **Group Markets (GM)** segment comprises trading and markets services as well as customer business with financial institutions. It includes all activities related to the trading books of Erste Group, including the execution of trade, market making and short-term liquidity management. In addition, it comprises business connected with servicing financial institutions as clients including custody, depository services, commercial business (loans, cash management, trade & export finance).

The **Asset/Liability Management & Local Corporate Center (ALM & LCC)** segment includes all asset/liability management functions – local and of Erste Group Bank AG (Holding) – as well as the local corporate centers which comprise internal service providers that operate on a non-profit basis and reconciliation items to local entity results. The corporate center of Erste Group Bank AG is included in the Group Corporate Center segment.

The **Savings Banks** segment includes those savings banks which are members of the Haftungsverbund (cross-guarantee system) of the Austrian savings banks sector and in which Erste Group does not hold a majority stake but which are fully controlled according to IFRS 10. The fully or majority owned Erste Bank Oesterreich, Tiroler Sparkasse, Salzburger Sparkasse and Sparkasse Hainburg are not part of the Savings Banks segment.

The **Group Corporate Center (GCC)** segment covers mainly centrally managed activities and items that are not directly allocated to other segments. It comprises the corporate center of Erste Group Bank AG (and thus dividends and the refinancing costs from participations, general administrative expenses), non-profit internal service providers (facility management, IT, procurement), the banking tax of Erste Group Bank AG as well as free capital of Erste Group (defined as the difference of the total average IFRS equity and the average economic equity allocated to the segments).

Intragroup Elimination (IC) is not defined as a segment but is the reconciliation to the consolidated accounting result. It includes all intragroup eliminations between participations of Erste Group (e.g. intragroup funding, internal cost charges). Intragroup eliminations within partial groups are disclosed in the respective segments.

RETAIL

Financial review

in EUR million	2016	2017	Change
Net interest income	2,198.2	2,155.7	-1.9%
Net fee and commission income	958.4	1,003.8	4.7%
Net trading result	99.6	114.0	14.5%
Operating income	3,286.3	3,304.4	0.6%
Operating expenses	-1,892.8	-1,995.8	5.4%
Operating result	1,393.5	1,308.6	-6.1%
Cost/income ratio	57.6%	60.4%	
Net impairment loss on financial assets	-19.1	9.5	n/a
Other result	-110.8	-60.4	-45.5%
Net result attributable to owners of the parent	964.6	960.7	-0.4%
Return on allocated capital	42.0%	40.5%	

Net interest income declined on the back of lower contributions from deposit business in Austria and the Czech Republic as well as lower contributions from lending business in Romania and Slovakia. These developments were partially mitigated by an increasing secured loan portfolio as well as the shift of clients from the Corporates segment in Austria, improved performance of deposit business in Croatia and Slovakia as well as additional income generated by the unsecured portfolio of the acquired business of Citibank in Hungary. Net fee and commission income increased primarily due to higher securities and payment transfer fees in Austria. The former Citibank retail business in Hungary also contributed positively. Net trading went up due to the higher income from client foreign exchange transactions in Romania and the Czech Republic and the increased client base in Hungary. Operating expenses increased primarily due to higher costs in Hungary and Slovakia as well as higher costs in Austria triggered by the shift of clients from the Corporates segment. Operating result thus declined, the cost/income ratio went up. The significant improvement of net impairment loss on financial assets was driven by releases of risk provisions in the Czech Republic, Austria and Romania. Other result improved due to the non-recurrence of high litigation provisions in Romania booked last year. Overall, the net result attributable to the owners of the parent marginally decreased.

Credit risk

Credit risk exposure in the Retail segment rose strongly to EUR 59.7 billion (+10.6%). The customer loan portfolio increased to EUR 52.7 billion (+8.8%). The share of the retail business in Erste Group's total customer loans was up at 36.7% (35.8%). The collateralisation ratio, which reflects the ratio of collateral to loan volume, stood at 63.0% (63.7%). The quality of the retail customer loan portfolio improved again significantly. Non-performing loans as a percentage of total retail customer loans decreased to 3.2% (4.0%). In terms of the NPL ratio, this segment continued to feature the highest quality of all business segments with a significant loan portfolio. In addition to the decline of non-performing loans by EUR 254 million, a migration to better risk classes of performing loans took place. The share of low-risk loans as a percentage of total retail customer loans rose to 86.3% (84.6%). The NPL coverage ratio based on loan loss provisions rose to 78.0% (75.2%).

CORPORATES

Financial review

in EUR million	2016	2017	Change
Net interest income	1,015.6	993.9	-2.1%
Net fee and commission income	259.1	256.2	-1.1%
Net trading result	90.7	91.6	1.0%
Operating income	1,504.7	1,469.9	-2.3%
Operating expenses	-562.4	-577.0	2.6%
Operating result	942.4	892.9	-5.2%
Cost/income ratio	37.4%	39.3%	
Net impairment loss on financial assets	-61.9	-135.3	>100.0%
Other result	-10.2	-13.9	37.2%
Net result attributable to owners of the parent	653.0	580.3	-11.1%
Return on allocated capital	22.3%	18.8%	

Net interest income decreased primarily due to the lower contribution of business in Austria partially caused by the shift of clients to the Retail segment of Erste Bank Oesterreich. Net interest income in Croatia was negatively impacted by lower contribution of the lending business. A better result from early repayment fees in the Czech Republic, higher guarantee fees in Hungary as well as higher lending fees in Croatia partially compensated the negative impact of the shift of customers in Austria on net fee and commission income. The moderate increase in the net trading result was mainly attributable to valuation effects of derivatives in Erste Bank Oesterreich. Rental income was negatively influenced by the sale of real estate SPVs in the Czech Republic and decreasing volumes of operating lease in Croatia. As a result, operating income went down. Higher operating expenses driven by project-related costs contributed to the decrease of the operating result and the increase in the cost/income ratio. Net impairment loss on financial assets increased significantly on the back of lower income from insurance claims in Romania as well as downgrading of one customer in Croatia. On the other hand, risk costs in the Czech Republic and Erste Bank Oesterreich decreased. Other result improved mainly due to the release of provisions for litigations in Hungary. Consequently, the net result attributable to the owners of the parent decreased.

Credit risk

Credit risk exposure in the Corporates segment rose to EUR 64.1 billion (+4.4%). Loans to customers increased to EUR 47.2 billion (+5.7%). As a percentage of Erste Group's total loans to customers they slightly declined to 32.9% (33.1%). The difference between credit risk exposure and the customer loan portfolio is primarily due to a large volume of guarantees and unused loan commitments. Active management of non-performing loans through restructuring and write-downs resulted in a significant improvement of the asset quality in the Corporates segment. Sales of non-performing loans played a lesser role than in previous years. The NPL ratio dropped to 4.9% (6.1%). The share of low risk loans rose to 86.3% (84.3%). The NPL coverage ratio based on loan loss provisions stood at 69.4% (72.3%).

GROUP MARKETS

Financial review

in EUR million	2016	2017	Change
Net interest income	212.1	196.8	-7.2%
Net fee and commission income	203.7	223.0	9.4%
Net trading result	94.3	123.8	31.2%
Operating income	515.1	554.1	7.6%
Operating expenses	-223.4	-229.5	2.7%
Operating result	291.7	324.6	11.3%
Cost/income ratio	43.4%	41.4%	
Net impairment loss on financial assets	11.4	3.6	-68.4%
Other result	4.9	-11.5	n/a
Net result attributable to owners of the parent	235.6	245.7	4.3%
Return on allocated capital	37.6%	36.9%	

Net interest income decreased primarily due to the generally low interest rate environment, lower volumes of collateral trading products and lower margins on sight deposits of financial institutions. Net fee and commission income rose on the back of increased sales activities, higher assets under management and arrangement fees related to debt issuance. The increase in net trading result was attributable to positive market developments affecting fixed income, money market, collateral trading and credit trading products. Therefore, operating income improved. Although operating expenses went up on the back of higher project-related costs, operating result as well as the cost/income ratio improved. Other result deteriorated due to the booking of one-off income from the resolution of a claim last year. Overall, the net result attributable to the owners of the parent increased.

ASSET/LIABILITY MANAGEMENT & LOCAL CORPORATE CENTER

Financial review

in EUR million	2016	2017	Change
Net interest income	-93.7	-55.4	-40.9%
Net fee and commission income	-64.4	-87.4	35.6%
Net trading result	-10.2	-74.3	>100.0%
Operating income	-135.2	-191.2	41.4%
Operating expenses	-117.3	-86.0	-26.7%
Operating result	-252.5	-277.2	9.8%
Cost/income ratio	-86.8%	-45.0%	
Net impairment loss on financial assets	-9.6	-8.3	-13.4%
Other result	-28.2	-142.9	>100.0%
Net result attributable to owners of the parent	-214.4	-359.3	67.6%
Return on allocated capital	-9.6%	-17.7%	

Net interest income increased mainly due to a higher contribution from deposits in Erste Bank Oesterreich partially offset by the lower result from derivatives in the Holding. The decrease in net fee and commission income was primarily related to lower fee income in the Czech Republic. The deterioration of net trading result as well as the result from financial assets and liabilities designated at fair value through profit or loss was driven by valuation results in the Holding. The decrease in operating expenses was mainly attributable to lower costs in Slovakia. Overall, operating result declined. Other result worsened mainly due to the non-recurrence of the selling gains on the shares of VISA Europe in 2016 (EUR 138.7 million) as well as provisions for expected losses from loans to consumers due to supreme court rulings regarding negative reference interest rates in Erste Bank Oesterreich in 2017 (EUR 13.7 million). These effects were partially compensated for by the substantial decrease of banking tax in Erste Bank Oesterreich after a one-off payment in the amount of EUR 25.4 million in 2016. The net result attributable to the owners of the parent decreased.

SAVINGS BANKS

Financial review

in EUR million	2016	2017	Change
Net interest income	955.8	982.0	2.7%
Net fee and commission income	429.7	446.2	3.8%
Net trading result	5.3	10.2	91.4%
Operating income	1,446.0	1,492.9	3.2%
Operating expenses	-1,021.8	-1,051.2	2.9%
Operating result	424.2	441.7	4.1%
Cost/income ratio	70.7%	70.4%	
Net impairment loss on financial assets	-54.2	12.6	n/a
Other result	-56.8	-38.0	-33.2%
Net result attributable to owners of the parent	34.1	51.9	52.4%
Return on allocated capital	9.3%	14.7%	

The increase in net interest income was mainly attributable to higher loan volumes and lower interest expenses, which was partially offset by the effect of the implementation of supreme court rulings regarding negative reference interest rates for consumer loans. Net fee and commission income increased mostly due to higher fees from securities business and payments. Net trading result improved on the back of positive valuation results. Operating expenses went up due to higher IT expenses. The booking of deposit insurance contributions for the full year amounted to EUR 27.0 million (EUR 24.2 million). Therefore, operating result increased and the cost/income ratio improved. Net impairment loss on financial assets decreased substantially. Other result improved due to selling gains of AfS securities and the decrease of banking tax to EUR 4.4 million (EUR 47.0 million – including a one-off payment in the amount of EUR 32.6 million) despite provisions for expected losses from loans to consumers due to supreme court rulings regarding negative reference interest rates (EUR 31.3 million) and higher provisions for contingent liabilities. The payment into the resolution fund amounted to EUR 6.4 million (EUR 8.5 million). Overall, the net result attributable to the owners of the parent increased.

Credit risk

Credit risk exposure in the Savings Banks segment increased to EUR 57.7 billion (+2.8%) while loans to customers rose to EUR 42.1 billion (+3.7%). Their share in Erste Group's total customer loans amounted to 29.4% (30.0%). Lending to private households increased at the same pace as loans to customers. Their share in the Savings Banks' total customer loan portfolio was unchanged at 38.3%. Lending to freelance professionals, other self-employed persons and small businesses grew by 0.9%. At 15.7% of total loans, the share of this customer segment was again significantly larger than at Erste Group's subsidiaries in Central and Eastern Europe. This reflects the structure of Austria's economy with a very high share of small and medium-sized enterprises compared with other countries. Swiss franc denominated foreign-currency loans declined further to EUR 2.2 billion (-25.1%). The trend towards higher collateralisation of loans continued. The quality of the loan portfolio was again very solid. Non-performing loans as a percentage of total loans to customers decreased to 4.2% (4.9%). The development was especially positive among corporate clients. The NPL coverage ratio based on loan loss provisions stood at 58.3% (58.1%).

GROUP CORPORATE CENTER

Financial Review

in EUR million	2016	2017	Change
Net interest income	77.4	74.9	-3.2%
Net fee and commission income	6.4	13.0	>100.0%
Net trading result	3.7	-41.5	n/a
Operating income	112.0	73.1	-34.8%
Operating expenses	-871.5	-996.4	14.3%
Operating result	-759.4	-923.3	21.6%
Cost/income ratio	>100.0%	>100.0%	
Net impairment loss on financial assets	-62.2	-14.1	-77.3%
Other result	307.3	709.2	>100.0%
Net result attributable to owners of the parent	-408.1	-163.2	-60.0%
Return on allocated capital	-7.2%	-2.0%	

Operating income declined mainly due to lower valuation results. The increase in operating expenses was primarily driven by higher IT costs. Other result improved significantly on the back of lower Austrian banking tax impacted by a one-off payment in the amount of EUR 138.3 million in the previous year. In 2016 this line item also included partial impairment of the goodwill in Slovenská sporitel'ňa in the amount of EUR 61.3 million. Consequently, the net result attributable to the owners of the parent improved significantly.

Geographical segments

For the purpose of segment reporting by geographical areas, the information is presented based on the location of the booking entity (not the country of risk). In the case of information regarding a partial group, the allocation is based on the location of the respective parent entity according to the local management responsibility.

Geographical areas are defined according to the country markets in which Erste Group operates. Based on the locations of the banking and other financial institution participations, the geographical areas consist of two core markets, Austria and Central and Eastern Europe and a residual segment Other that comprises the remaining business activities of Erste Group outside its core markets as well as the reconciliation to the consolidated accounting result.

The geographical area **Austria** consists of three segments:

_ The **Erste Bank Oesterreich & Subsidiaries** (EBOe & Subsidiaries) segment comprises Erste Bank der oesterreichischen Sparkassen AG (Erste Bank Oesterreich) and its main subsidiaries (e.g. sBausparkasse, Salzburger Sparkasse, Tiroler Sparkasse, Sparkasse Hainburg).
_ The **Savings Banks** segment is identical to the business segment Savings Banks.
_ The **Other Austria** segment comprises Erste Group Bank AG (Holding) with its Corporates and Group Markets business, Erste Group Immorent, Erste Asset Management and Intermarket Bank.

The geographical area **Central and Eastern Europe (CEE)** consists of six segments covering Erste Group's banking subsidiaries located in the respective CEE countries:

_ **Czech Republic** (comprising Česká spořitelna Group)
_ **Slovakia** (comprising Slovenská sporiteľňa Group)
_ **Romania** (comprising Banca Comercială Română Group)
_ **Hungary** (comprising Erste Bank Hungary Group)
_ **Croatia** (comprising Erste Bank Croatia Group) and
_ **Serbia** (comprising Erste Bank Serbia Group)

The residual segment **Other** covers mainly centrally managed activities and items that are not directly allocated to other segments. It comprises the corporate center of Erste Group Bank AG (and thus dividends and the refinancing costs from participations, general administrative expenses), internal non-profit service providers (facility management, IT, procurement), the banking tax of Erste Group Bank AG as well as free capital of Erste Group (defined as the difference of the total average IFRS equity and the average economic equity allocated to the segments). Asset/Liability Management of Erste Group Bank AG as well as the reconciliation to the consolidated accounting result (e.g. intercompany eliminations, dividend eliminations) are also part of the segment Other.

Austria

Economic review

The developed and open economy of Austria is well diversified across industries, benefiting from a high value adding industrial base, well-educated workforce and a strong tourism and service sector. Economic growth in 2017 was the strongest in six years, driven mainly by solid domestic consumption and increased investment activity. Net exports were also strong and contributed to economic growth. Consumer confidence indicators showed an upswing. The robust economic activity resulted in a decline of the unemployment rate; it reversed its negative trend and improved for the first time in five years. The unemployment rate declined to 5.5%. In terms of GDP per capita at EUR 42,000, Austria remained one of the wealthiest countries in the euro zone. Overall, real GDP grew by 2.9%.

Following early parliamentary elections in October 2017, a new coalition headed by the People's Party was formed. The fiscal position of the country remained stable and Austria kept its general government deficit at a relatively low level of 1.0%. Revenues were significantly supported by the inflows from personal income tax and higher social security contributions, which reflected the rise in employment. Government expenses increased only moderately, mainly due to lower debt service costs. Public debt as a percentage of GDP decreased from 83.6% in 2016 to 80.8% in 2017. Reflecting the country's performance, all major rating agencies affirmed their strong ratings for Austria. At year-end, Standard & Poor's and Fitch had the country's long-term credit rating with a stable outlook at AA+, Moody's at Aa1, also with a stable outlook.

Although the economic upswing led to increasing inflation, it remained at a moderate level. Property prices continued to rise moderately in 2017. The price increase in the service sector was most pronounced in tourism. Overall, average consumer prices increased by 2.2%. The European Central Bank continued its expansionary monetary policy and left the key interest rate untouched at 0% throughout 2017.

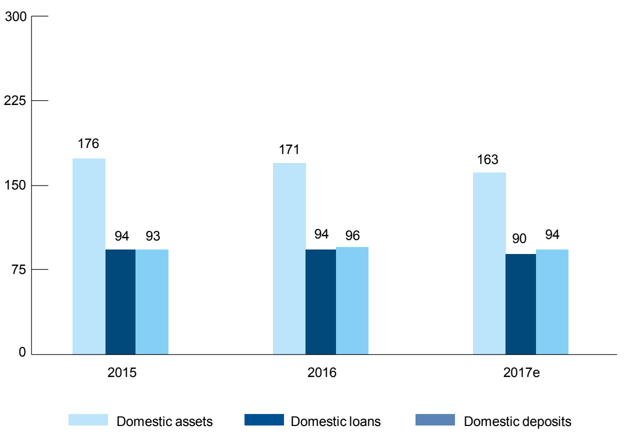
Key economic indicators – Austria	2014	2015	2016	2017e
Population (ave, million)	8.5	8.6	8.7	8.8
GDP (nominal, EUR billion)	333.1	344.5	353.3	369.2
GDP/capita (in EUR thousand)	39.0	39.9	40.4	42.0
Real GDP growth	0.8	1.1	1.5	2.9
Private consumption growth	0.4	0.8	1.7	1.3
Exports (share of GDP)	39.5	39.7	39.8	41.2
Imports (share of GDP)	41.0	41.2	4.2	43.1
Unemployment (Eurostat definition)	5.6	5.7	6.0	5.5
Consumer price inflation (ave)	1.5	0.8	1.0	2.2
Short term interest rate (3 months average)	0.1	0.0	-0.3	-0.3
EUR FX rate (ave)	1.0	1.0	1.0	1.0
EUR FX rate (eop)	1.0	1.0	1.0	1.0
Current account balance (share of GDP)	2.5	1.9	2.1	2.2
General government balance (share of GDP)	-2.7	-1.0	-1.6	-1.0

Source: Erste Group

Market review

The Austrian banking market, with total assets of 224% of GDP in 2017, has the characteristics of a developed banking market. It remains very competitive and continues to suffer from low margins. Challenges to profitability also persist in the form of relatively high costs compared to banking markets in CEE. On the other hand, the country's banking market benefits from traditionally low risk costs and the significant reduction of the banking tax in 2017. The market continued to grow with customer loans expanding by 1.4% and deposits growing by 4.0% as of September 2017. The banking system's loan-to deposit-ratio ratio stood at 95.7%.

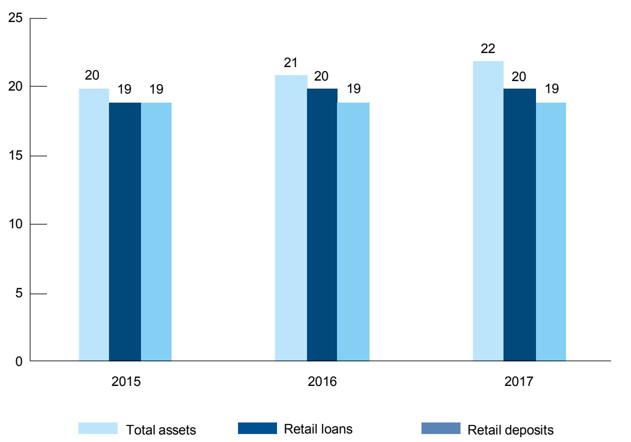
Financial intermediation – Austria (in % of GDP)



Source: Oesterreichische Nationalbank (data as of Q3 2017), Erste Group

The Austrian Supreme Court confirmed that, for consumer loans, with respect to the margin used to calculate the applicable interest rate, it is impermissible to fix a floor for such margin while not at the same time fixing a ceiling. Thus, banks are obligated to reimburse improperly-calculated interest to the affected consumers as well as to adjust the calculation of interest for future payments. At the same time, the Supreme Court confirmed that negative base rates in the loan markets cannot trigger a reversal of payment obligations.

Market shares – Austria (in %)



Source: Oesterreichische Nationalbank (data as of Q3 2017), Erste Group

Erste Bank Oesterreich and the savings banks continued to have a very strong market position in the Austrian market. Based on their balanced business model, they further increased their combined market shares to between 19% and 21% in both retail and corporate segments. Importantly, *George*, the digital banking platform developed by Erste Group Bank AG's in-house fintech, has already become the country's most modern and popular banking platform. Its 1.5 million users represents more than every third online banking user in Austria. Altogether, the market share of Erste Bank Oesterreich and the savings banks in terms of total assets stood at 22.0%. The three largest banking groups of the Austrian market continued to have a combined market share of than 60% in customer loans and deposits.

ERSTE BANK OESTERREICH & SUBSIDIARIES

Business review – Highlights

Innovation in banking. By launching its digital platform *George* and the mobile App *George Go*, Erste Bank Oesterreich affirmed its position as innovation leader in the market. Mobile use of digital banking services has strongly increased. By year-end 2017, 1.5 million users had already signed up for *George*. *George* is being continuously expanded and also offers services for corporate customers.

The bank's digital offering also includes consumer loans and enables customers to open bank accounts using video identification.

New branch concept. The rollout of the new branch concept was continued. Simple business is dealt with quickly at newly designed service centres situated at high-frequency locations, along people's daily routes. For more complex customer needs, Erste Bank Oesterreich offers a wide range of products and services at its large advisory branches. For customers, this means clearly designed and welcoming branches, rooms for private meetings, faster handling of their requests and proactive support in the foyers entry areas. Customer satisfaction increased at all newly opened advisory branches.

High customer satisfaction, strong growth. Erste Bank Oesterreich regularly conducts customer surveys to maintain and further improve its high level of customer service quality. In 2017, best marks were achieved in all three satisfaction categories (satisfaction with the bank, the branch, the relationship manager) in both the retail and the corporate customers' segments. The number of newly acquired customers amounted to more than 43,000 (net).

Continued growth. Net loans increased again significantly in 2017. Small and medium-sized enterprises increasingly turned to Erste Bank Oesterreich to fund their investment spending. In the retail business, demand for mortgage loans remained high. Attractive offerings with fixed interest rates – also for longer maturities – allow Erste Bank Oesterreich's customers to benefit from and lock in low interest rates. Significantly more than half of all housing loans were granted at fixed interest rates. Consumer loans were also up significantly, which was attributable in particular to online consumer loans, which can be contracted quickly and easily through *George*.

International recognition. Erste Group won the prestigious *Best Private Bank in CEE* award conferred by the financial magazine *The Banker* for the fourth time in a row and was also recognised once again for *Best Private Banking in Austria*.

Financial review

in EUR million	2016	2017	Change
Net interest income	660.5	631.2	-4.4%
Net fee and commission income	334.6	353.8	5.7%
Net trading result	16.1	18.9	17.0%
Operating income	1,057.5	1,053.7	-0.4%
Operating expenses	-666.9	-679.6	1.9%
Operating result	390.6	374.1	-4.2%
Cost/income ratio	63.1%	64.5%	
Net impairment loss on financial assets	-29.3	26.1	n/a
Other result	-18.5	-27.5	48.3%
Net result attributable to owners of the parent	228.4	253.2	10.9%
Return on allocated capital	19.3%	21.1%	

Net interest income decreased due to a change in accrual policy at the building society, a change in the scope of consolidation and the effect of the implementation of supreme court rulings regarding negative reference interest rates for consumer loans, which was only partially compensated for by higher customer loan volumes and re-pricing of deposits. Net fee and commission income increased due to higher securities, payments and insurance fees, as well as a change in accrual policy at the building society. The net trading result increased slightly due to valuation effects of derivatives. Operating expenses increased mainly on the back of higher IT costs. The booking of deposit insurance contributions also rose to EUR 21.7 million (EUR 19.2 million). Consequently, operating result decreased and the cost/income ratio deteriorated. Net impairment loss on financial assets benefited from lower provisioning requirements in corporate and retail business. The deterioration of other result was driven by non-recurrence of the selling gains from buildings and related to the sale of shares in Visa Europe (EUR 12.2 million) in 2016 as well as by provisions for expected losses from loans to consumers due to Supreme Court rulings regarding negative reference interest rates (EUR 13.7 million). Banking tax decreased to EUR 3.3 million (EUR 44.4 million; including a one-off payment in the amount of EUR 30.0 million). Payment into the resolution fund decreased to EUR 6.1 million (EUR 7.2 million). Overall, the net result attributable to the owners of the parent improved.

Credit risk

Credit risk exposure in the Erste Bank Oesterreich and Subsidiaries segment increased marginally to EUR 39.3 billion (+0.8%) while the volume of customer loans rose more visibly to EUR 31.8 billion (+2.4%). The share of this segment in Erste Group's total loan portfolio declined to 22.1% (23.0%). The share of retail customers in total loan volume was almost unchanged at 39.9% (40.0%). The share of corporates, including self-employed individuals and small businesses, was constant at 53.8% (53.9%). Loans to freelance professionals, other self-employed persons and small businesses are less significant than they are for the savings banks and amounted to 10.1% (9.8%) of total loans to customers. Lending to the public sector increased more substantially to EUR 2.0 billion (+6.4%). Owing to the continued campaign promoting the conversion of foreign currency loans to euro, the share of Swiss franc loans in the total loan portfolio decreased further to 5.0% (6.7%). The quality of the loan portfolio improved again. While low-risk loans registered above-average growth, non-performing loans as a percentage of total loans to customers declined to 2.0% (2.5%). The development was positive across all customer segments, but most visible among medium-sized and larger enterprises. Default rates remained lowest in the public sector and private households customer segments. The NPL coverage ratio based on loan loss provisions stood at 57.1% (59.3%).

SAVINGS BANKS

The geographical segment Savings Banks is identical to the business segment Savings Banks (see page 33).

Business review – Highlights

Growth in a low interest rate environment. Like Erste Bank Oesterreich, the savings banks also achieved significant growth in deposits and loans. Loans grew by 3.5%, while the increase in deposits was more pronounced at 6.6%. These growth rates were the result of the excellent customer support and high service quality but also the successful positioning as an innovative provider of banking services and the positive image that resulted from it.

Reducing complexity. The measures taken by the savings banks to further reduce the complexity of work processes and simplify the products offered not only create added value for the customers but will also improve the cost/income ratio over the medium term.

Innovation in banking. For the savings banks innovation is key to creating more value for customers and raising customer satisfaction. With *George*, Erste Bank Oesterreich and the savings banks have developed a modern platform that already boasts a large number of active users.

OTHER AUSTRIA

Business review – Highlights

Strong performance of Erste Asset Management. Erste Asset Management (Erste AM) continued to expand its business volume despite difficult market conditions. Assets under management rose to EUR 63.3 billion (+10.7%). In terms of assets under management Erste AM is market leader in Austria, Romania, the Czech Republic and now also in Croatia.

The *ERSTE BOND CORPORATE PLUS* fund launched at the end of 2016 is one of the most successful product innovations with an annualised performance of 8.5%. Erste AM expanded its range of sustainable products. In March 2017, it launched the *ERSTE RESPONSIBLE STOCK DIVIDEND* fund. The fund has been awarded the Austrian Ecolabel for meeting relevant sustainability criteria.

At the Austrian fund of funds awards, Erste AM received 16 awards and ranked first in five categories. EAM was also awarded the FNG label for ten of its sustainable funds. Created by Forum Nachhaltige Geldanlagen e.V. (FNG), the FNG label is the quality standard for sustainable financial investment in German-speaking countries.

Group Markets business. Group Markets activities comprise trading and markets services as well as the entire financial institutions customer business.

Erste Group was one of the bookrunning syndicate banks in the Initial Public Offerings (IPO) of Dino Polska on the Warsaw Stock Exchange and Waberer International on the Budapest Stock Exchange. In addition, Erste Group was a leading syndicate bank in the capital increase of Agrana, listed on the Vienna Stock Exchange.

Erste Group acted as joint bookrunner on the issuance of the EUR 3.5 billion century bond as well as the EUR 4 billion benchmark bond both issued by the Republic of Austria.

Commercial real estate business. Due to strong new business generation the portfolio volume remained stable despite growing competition for financing of real estate assets across Austria and CEE. The robust risk profile of the new business supported the continued improvement of the overall portfolio quality and diversification. More than half of the new business volume was attributable to Austria and the Czech Republic.

As a result of the consistent high service quality in the commercial real estate business, Erste Group was named *Lender of the Year* at the CEE Quality Awards.

Erste Group Immorent completed the development of the Enterprise Office building in Prague, which is considered a landmark office development and was sold with a significant profit. While the commercial real estate business was almost equally distributed between the asset classes logistics, office and retail, the share of financing of commercial development declined.

Group Corporates business. The integrated corporate banking business model benefits from profound sector know how of the local entities and a group-wide steering approach making it possible to utilise cross-selling opportunities.

Erste Group again demonstrated its syndicated loan capabilities domestically and internationally. Erste Group acted as coordinator, mandated lead arranger and bookrunner on a EUR 1 billion revolving credit facility for Novomatic, closing the deal with 13 international banks. Another example was the EUR 250 million loan for Egger Holzwerkstoffe, the subsidiary of a leading, Austrian based producer of wood composites. Erste Group acted as agent for a group of Egger's relationship banks.

In project finance, Erste Group focused on financing renewable energy projects in CEE. The wind power sector is a steady contributor to the financing pipeline, particularly in Croatia and Serbia. In Hungary, after years of stagnation, photovoltaic projects have gained in importance. The total project volume in various stages of debt financing in 2017 amounted to EUR 1 billion, mainly allocated to wind, solar and waste to energy projects.

Overall, Erste Group's successes in capital markets, corporate finance and transaction banking improved its market position in the large corporates business.

Group Research. In addition to its research publications, Erste Group organised institutional investor conferences in London, New York, Chicago and Stegersbach/Austria. Some 80 stock-listed companies of Erste Group's core markets in CEE attended the conference in Stegersbach.

Financial review

in EUR million	2016	2017	Change
Net interest income	401.6	372.2	-7.3%
Net fee and commission income	197.8	216.6	9.5%
Net trading result	18.3	50.7	>100.0%
Operating income	681.7	708.0	3.9%
Operating expenses	-355.5	-373.8	5.1%
Operating result	326.2	334.2	2.5%
Cost/income ratio	52.2%	52.8%	
Net impairment loss on financial assets	-23.5	-40.0	69.8%
Other result	25.6	3.4	-86.7%
Net result attributable to owners of the parent	248.1	228.6	-7.8%
Return on allocated capital	16.6%	15.5%	

Net interest income declined primarily as a result of lower income from credit trading positions in Group Markets business, a decrease of lending margins in the corporate loan portfolio in New York branch and the non-recurrence of a positive one-off impact in the real estate business in Austria. Net fee and commission income increased due to higher asset management volumes and a wider scope of consolidation at Erste Asset Management, as well as the inclusion of Intermarket Bank (reported as part of EBOe & Subsidiaries segment in 2016). The increase of net trading result was predominantly attributable to better performance of interest rate derivatives. Despite an increase in operating expenses, mostly driven by higher project costs, overall operating result improved. Cost/income ratio remained stable. Net impairment loss on financial assets increased as an effect of downgrading selected corporate customers. Other result deteriorated mostly due to higher off-balance provisions and a non-recurrence of the positive effect from the resolution of a claim in the previous year. This line item also included a resolution fund contribution of EUR 3.6 million (EUR 3.1 million). Overall, the net result attributable to the owners of the parent deteriorated.

Credit risk

Credit risk exposure in the Other Austria segment, which is almost completely made up of Erste Group Bank AG and Erste Group Immorent GmbH, declined further, albeit at a slower pace than in previous years, to EUR 28.8 billion (-1.1%) or to 12.7% (13.6%) of Erste Group's credit risk exposure. A large share of the business in this segment was accounted for by securities and investments with banks. Consequently, the share of loans to customers as a percentage of Erste Group's total loan portfolio was significantly lower than the contribution to credit risk exposure. In 2017, it was nearly unchanged at 9.1% (9.3%). While commercial real estate financing declined further to EUR 3.4 billion (-5.6%), loans to medium-sized enterprises and large corporates increased. Non-performing loans were up marginally, accounting for 5.6% (5.5%) of the total loan portfolio. Within the category of performing loans, there was a clear migration to better risk categories. The NPL coverage ratio based on loan loss provisions declined to 50.2% (63.9%).

Central and Eastern Europe

CZECH REPUBLIC

Economic review

The Czech Republic remained one of the most successful economies in Central Europe. With real GDP expanding by 4.5% and GDP per capita increasing further to EUR 18,200 the country's convergence towards more developed Western European economies continued. Although the Czech Republic is among the most open economies in the region, growth in 2017 was mainly supported by household consumption and investments. Consumption benefitted significantly from higher consumer confidence, lower unemployment and accelerating growth of real wages. Investments were positively impacted by a robust EU funds absorption rate and a labour market characterised by full employment, which incentivised enterprises to invest in automation. Economic recovery in the euro zone, which spurred demand for Czech exports, also played an important role in the economic development. Industrial production benefitted significantly from the strong performance of the automotive industry. Czech passenger car production increased by 5.2% to more than 1.4 million vehicles in 2017. Reflecting the strong economic performance, the unemployment rate decreased further to 2.9%, and remained the lowest in the European Union.

Parliamentary elections were held in October 2017. The ANO movement won the elections by a significant margin. The country's political landscape remained diverse as nine parties and movements passed the minimum electoral threshold of 5%. Despite 2017 being an election year fiscal prudence prevailed, as expressed by a budget surplus of 0.6%. State revenues were positively impacted by growing tax revenues due to measures addressing tax avoidance and higher social contributions. These developments more than offset the significant increase of public wages. Public debt as a percentage of GDP was again one of the lowest in Central and Eastern Europe and declined further to 33.9%. These economic developments were also acknowledged by Fitch which revised the country's outlook from stable to positive. At year-end, Fitch assessed the country's long term credit rating at A+, Standard & Poor's at AA- and Moody's at A1, the latter two with a stable outlook.

Inflation increased but remained within the Czech National Bank's range of 1% and 3%. Rising domestic demand, increasing wages, and higher food and services prices were partly counterbalanced by the strengthening of the Czech koruna following the Czech National Bank's decision in April 2017 to remove the exchange rate floor against the euro. Overall, the average consumer price index stood at 2.5%. Due to the favourable developments of the country's economy, the strong currency and increasing inflation the Czech National Bank decided to increase its key policy rate twice in the second half of 2017, from 0.05% to 0.5%. The Czech National Bank was the first in Central Europe to increase its key policy rate.

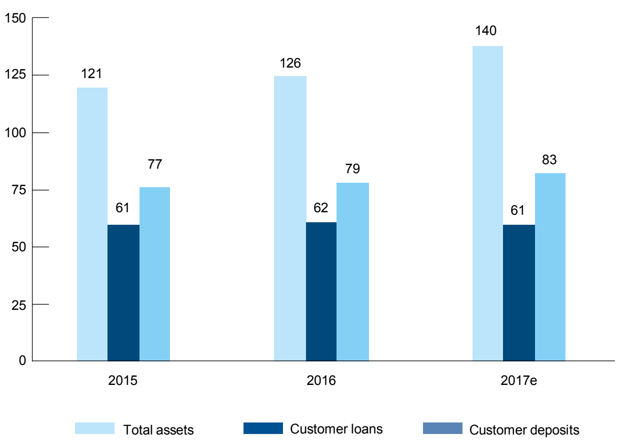
Key economic indicators – Czech Republic	2014	2015	2016	2017e
Population (ave, million)	10.5	10.5	10.6	10.6
GDP (nominal, EUR billion)	156.6	168.5	176.5	192.0
GDP/capita (in EUR thousand)	14.9	16.0	16.7	18.2
Real GDP growth	2.7	5.4	2.5	4.5
Private consumption growth	1.8	3.8	3.6	4.2
Exports (share of GDP)	75.1	74.8	75.2	76.0
Imports (share of GDP)	69.7	70.0	69.5	69.8
Unemployment (Eurostat definition)	6.2	5.1	4.0	2.9
Consumer price inflation (ave)	0.4	0.4	0.7	2.5
Short term interest rate (3 months average)	0.4	0.3	0.3	0.4
EUR FX rate (ave)	27.5	27.3	27.0	26.3
EUR FX rate (eop)	27.9	27.1	27.0	25.5
Current account balance (share of GDP)	0.2	0.2	1.1	1.2
General government balance (share of GDP)	-1.9	-0.4	0.5	0.6

Source: Erste Group

Market review

The Czech banking market benefitted from the positive macroeconomic environment and displayed rising demand for banking products. Supported by increased household consumption and improved consumer confidence, customer loans increased by 4.6%. Lending growth was attributable to both retail and corporate loans. Likewise, the 10.7% of customer deposit growth was equally balanced. Overall, the Czech banking market remained one of the most liquid in Central and Eastern Europe. The loan-to-deposit ratio across the banking sector stood at 74.0% at the end of 2017. The solid fundamentals were also demonstrated by the banking sector's total capital ratio of 19.3%. The three largest banks continued to have a combined market share of approximately 60% in customer loans and deposits.

Financial intermediation – Czech Republic (in % of GDP)

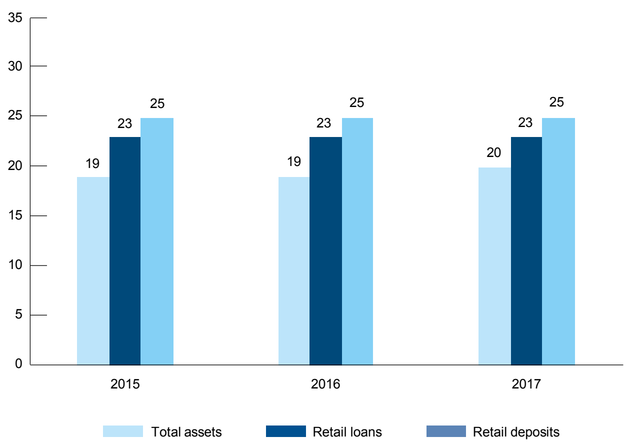


Source: Czech National Bank, Erste Group

Despite the low interest rate environment and margin pressure, the Czech banking market achieved another very profitable year. Positive asset quality trends continued and the ratio of non-performing loans declined to 4.0%, one of the lowest in the European Union. The sector's strength was demonstrated by the return on equity of 17.0%. Regulatory topics also played a significant role in the development of the Czech banking market throughout 2017. The Czech National Bank decided to further increase the countercyclical capital buffer to 1.25% as of 2019 and set stricter lending rules on secured loans regarding loan to value, debt to income, and debt service to income ratios.

Česká spořitelna maintained its market leadership positions across all product categories. Its retail market shares ranged from 23% to 28%, while its market shares in the corporate segment increased to above 20%. Česká spořitelna increased its market shares both in retail and corporate lending. The company retained its top position in consumer lending, including the credit card business, with a market share of 28.3%. Česká spořitelna further strengthened its strong position in asset management products, with a market share of approximately 26%, the highest in the country. Overall, its market share in terms of total assets stood at 19.8%.

Market shares – Czech Republic (in %)



Source: Czech National Bank, Erste Group

Business review – Highlights

Innovation and focus on customer relationships. Česká spořitelna puts a strong emphasis on the development of digital banking and improving customer satisfaction. The bank introduced *George* and more than 250,000 customers signed up during the pilot phase. The paperless loan and the online mortgage allow customers to finalise the loan application fully online, thus significantly reducing processing times.

My Healthy Finance, the bank's flagship retail banking service, extended its advisory services to the mass market segment. Overall, 720,000 customers signed up for the service by the end of the year. Thanks to *My Healthy Finance* Česká spořitelna improved customer satisfaction further, and the number of transactions done through digital channels increased significantly.

Success in mortgage and consumer lending. Česká spořitelna achieved double-digit growth in mortgage loans and retained its number two position on the market.

The positive economic situation and offerings of Česká spořitelna are also reflected in the consumer loan portfolio, the bank confirmed its number one position on the consumer loan market.

Solid performance in corporate business. Over the years, the bank has developed specialised programmes for individual industrial sectors focusing on smaller and medium-sized enterprises. The newly introduced offering *Easy Loan* significantly increased the business volume with SMEs. Due to an improved and accelerated credit application process, Česká spořitelna increased corporate loans substantially.

International and local recognition. Česká spořitelna has again received multiple awards. It was named *Best Bank* in the Czech Republic in the *Euromoney Awards for Excellence* and Erste Private Banking won the *World Finance award* for best private banking in the Czech Republic. Česká spořitelna defended the *Most Trustworthy Bank* in the prestigious competition Bank of the Year. In the *Golden Crown Competition*, it won awards for social responsibility, mortgages, supplementary pension savings and its building-society loans.

Financial review

in EUR million	2016	2017	Change
Net interest income	914.3	942.3	3.1%
Net fee and commission income	344.3	334.4	-2.9%
Net trading result	107.2	103.9	-3.0%
Operating income	1,384.5	1,393.4	0.6%
Operating expenses	-671.2	-692.8	3.2%
Operating result	713.3	700.6	-1.8%
Cost/income ratio	48.5%	49.7%	
Net impairment loss on financial assets	-70.5	-1.3	-98.2%
Other result	27.7	-35.2	n/a
Net result attributable to owners of the parent	542.0	532.9	-1.7%
Return on allocated capital	31.1%	26.3%	

The segment analysis has been performed on a constant currency basis. The CZK appreciated by 2.6% against the EUR in the reporting period. Net interest income in the Czech Republic segment (comprising Česká spořitelna Group) increased primarily due to rising interest rates and higher loan volumes. Net fee and commission income went down on the back of lower payment and lending fees as well as non-recurrence of the one-off positive impact from release of provisions for the customer incentive program in 2016. These developments were partially offset by higher fees from asset management and insurance brokerage. Net trading result decreased driven by lower derivative valuation results. Higher personnel and project-related costs led to an increase in operating expenses. Deposit insurance contributions amounted to EUR 8.3 million (EUR 7.4 million). Operating result thus decreased, the cost/income ratio went up. The decline of net impairment loss on financial assets was attributable to an improvement in corporate and retail portfolio quality resulting in releases of risk provisions. The other result deteriorated mainly due to the non-recurrence of last year's selling gains on the shares of VISA Europe in the amount of EUR 52.6 million. The resolution fund contribution amounted to EUR 16.2 million (EUR 14.7 million). Overall, these developments led to a decrease in the net result attributable to the owners of the parent.

Credit risk

Credit risk exposure in the Czech Republic segment rose significantly to EUR 45.2 billion (+23.6%) on the back of the benign economic environment, a substantial increase in the money market business and the 5.4% appreciation of the Czech koruna against the euro. Loans to customers rose at a slightly slower pace to EUR 25.5 billion (+16.2%), with growth almost evenly split between the retail and the corporate business. Customer loan volume as a percentage of Erste Group's total loans to customers increased to 17.8% (16.2%). In terms of business volume, the Czech Republic is thus still by far the second most important market for Erste Group after Austria. The quality of customer loans was significantly better than in Erste Group's other core markets in Central and Eastern Europe. Due to proactive and effective credit risk management, non-performing loans as a percentage of the total customer loan portfolio decreased to 2.1% (3.2%), which continued the positive development of recent years. Improvements were seen in all customer segments but most notably among corporate customers. Default rates were again lowest in the retail segment. The NPL coverage ratio based on loan loss provisions increased substantially to 92.5% (82.8%).

SLOVAKIA

Economic review

The Slovak economy displayed again a strong performance in 2017. Economic growth was mainly driven by robust household consumption. Investments also contributed to the favourable economic development. Consumption benefitted from further improvement in the labour market, growing real wages, and moderate inflation. Employment growth remained solid as the unemployment rate declined to a record low of 8.1%. Investments were supported by the expansion and construction of further automotive plants. Slovakia remained the world's top car producer per capita, and automotive was again the largest industry in Slovakia with a share of around 10% of the Slovak GDP. Overall, real GDP grew by 3.4%, while GDP per capita amounted to EUR 15,600 in 2017.

The fiscal position of Slovakia continued to improve. VAT and personal income tax revenues benefited from improving private consumption and labour market conditions. Higher ceiling amounts on social and healthcare contributions also played a role in the fiscal developments. As a result, the fiscal deficit declined from 2.2% to 1.5%. The country's public debt as a percentage of GDP remained low at 51.1%.

Slovakia experienced mild inflation in 2017 as consumer prices increased after three consecutive years of deflation. Inflation was impacted by higher food and services prices while energy prices declined on the back of lower electricity prices. Reflecting the upward pressure of the tightening labour market, nominal wage growth accelerated to 4.6%, the fastest rate since 2008. Overall, average consumer prices increased by 1.3%. The positive macroeconomic developments were recognised by Moody's which changed the country's outlook from stable to positive. As of the end of 2017, Moody's kept the country's long-term credit rating at A2, Standard & Poor's and Fitch, both with a stable outlook, at A+.

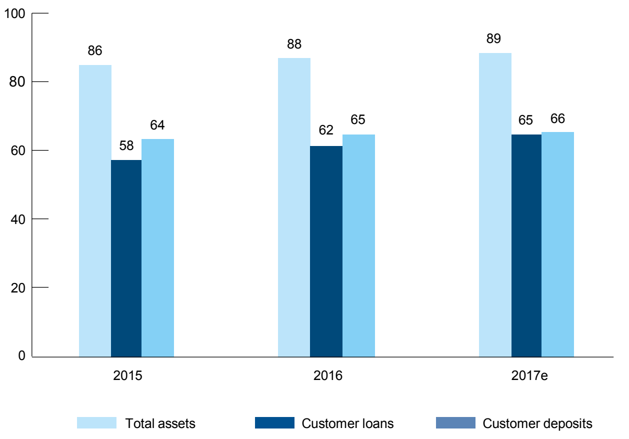
Key economic indicators – Slovakia	2014	2015	2016	2017e
Population (ave, million)	5.4	5.4	5.4	5.4
GDP (nominal, EUR billion)	76.1	78.9	81.2	85.0
GDP/capita (in EUR thousand)	14.0	14.5	14.9	15.6
Real GDP growth	2.8	3.9	3.3	3.4
Private consumption growth	1.4	2.3	2.6	3.7
Exports (share of GDP)	82.2	81.9	82.8	84.1
Imports (share of GDP)	78.6	80.6	80.7	82.6
Unemployment (Eurostat definition)	13.2	11.5	9.6	8.1
Consumer price inflation (ave)	-0.1	-0.3	-0.5	1.3
Short term interest rate (3 months average)	0.2	0.0	-0.3	-0.3
Current account balance (share of GDP)	1.1	-1.7	-1.5	-0.9
General government balance (share of GDP)	-2.7	-2.7	-2.2	-1.5

Source: Erste Group

Market review

The positive macroeconomic environment continued to favourably impact the country's banking market. Customer loans increased by 9.6%, with the retail business growing by 12.0% and corporate loans by 6.9%. Customer deposits, driven by both retail and corporate businesses, rose by 5.3%, resulting in a loan-to-deposit ratio of 99.3%. The three largest banks continued to have a combined market share of approximately 60% in customer loans and deposits. Consolidation of the sector continued with Sberbank's Slovak subsidiary merging with Prima banka. The banking sector remained well capitalised with a capital adequacy ratio of 18.6%.

Financial intermediation – Slovakia (in % of GDP)

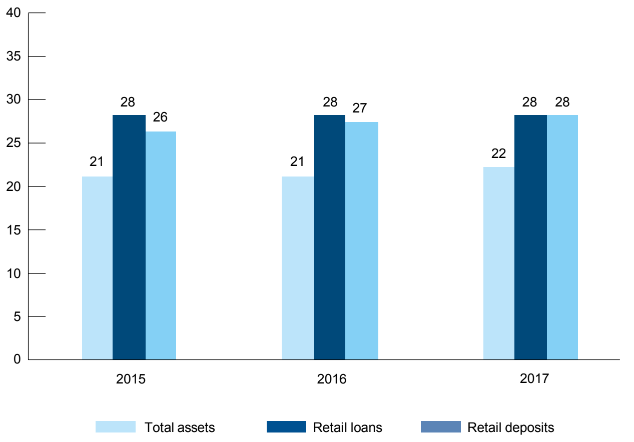


Source: National Bank of Slovakia, Erste Group

Despite suffering from the low interest rate environment, banking tax and regulatory changes, Slovakia's banking sector continued to be profitable in 2017. Low interest rates led to a decline in the net interest margin but also supported the positive asset quality trends throughout the year. The NPL ratio decreased further to 3.7%. Banks continued to pay banking tax at 0.2% of total liabilities excluding equity and subordinated debt. Overall, the sector's return on equity stood at 7.8% at the end of 2017.

Slovenská sporiteľňa successfully retained its leading market positions. The bank continued to control one fifth of the country's banking market in terms of total assets and led the market in retail loans and deposits. In the retail loan business, the bank's market share amounted to 27.7%. At 13.1%, its market share in corporate deposits was significantly lower than in retail deposits, which stood at 27.6%. Slovenská sporiteľňa maintained its strong position in asset management products with a market share of more than 25%.

Market shares – Slovakia (in %)



Source: National Bank of Slovakia, Erste Group

Business review – Highlights

New branch and advisory concept. Slovenská sporiteľňa continued its emphasis on redesigning the branch network and remodelling the advisory concept. Another 30 branches were redesigned and more than 20 deposit ATMs were installed, allowing customers not only to withdraw but also to deposit cash.

Following the reduction of purely transaction-related business at the branches, waiting times were reduced and previously tied capacities were freed-up for advisory services. The bank also intensified the usage of tablets by branch advisors. Tablets facilitate service interactions like discussions of financial needs or information about products. In addition, the usage of tablets simplifies the sales process, particularly for opening savings accounts and a newly introduced consumer loans offering. Overall, more than two million customer dialogues were supported by tablets in 2017, leading to substantially higher client activation. In addition, customer satisfaction improved substantially on the back of the new advisory concept.

Sales performance through digital channels. Slovenská sporiteľňa continued its innovation efforts and doubled the sales volume of consumer loans, overdrafts and credit cards in digital banking to more than EUR 100 million.

In the fourth quarter, the bank launched the pilot phase of the digital platform *George*. The roll-out is scheduled for 2018.

Focus on insurance products. Slovenská sporiteľňa increasingly offered its customers insurance products. In doing so, it reacted to the high demand, in particular for non-life insurance products, like household insurance or payment protection insurance. In addition, the bank piloted pension insurance in two regions. Following the success of this product launch, it is planned to rollout this offer into other regions in 2018.

Banking for corporate customers. The bank continued its focus on process improvements, rolling out a new integrated loan processing system. It aims at increasing efficiency through simplifying the lending process. *Business 24*, the digital banking channel for corporate customers, was further upgraded and now includes additional features for payment card management. In addition, a new and easy to use cash management and financial service tool, *Erste Confirming*, was introduced.

International and local recognition. Slovenská sporiteľňa was again awarded multiple prizes. It was named *Bank of the Year* in Slovakia by the financial magazine *The Banker* and ranked second in the *TREND Top Bank* of the Year. The bank also received the *Bank without barriers* award for the third consecutive year, and it ranked first in a survey conducted by the portal Profesia.sk as the country's best employer in the category banking, finance and insurance industry.

Financial review

in EUR million	2016	2017	Change
Net interest income	453.0	434.3	-4.1%
Net fee and commission income	121.7	112.7	-7.4%
Net trading result	13.5	13.8	2.3%
Operating income	595.4	568.7	-4.5%
Operating expenses	-275.1	-281.1	2.2%
Operating result	320.4	287.6	-10.2%
Cost/income ratio	46.2%	49.4%	
Net impairment loss on financial assets	-48.2	-30.1	-37.7%
Other result	11.0	-39.5	n/a
Net result attributable to owners of the parent	213.3	166.2	-22.1%
Return on allocated capital	33.7%	24.7%	

Net interest income in the Slovakia segment (comprising Slovenská sporitel'ňa Group) decreased mainly due to a lower asset/liability management contribution driven by the low interest rate environment and lower loan margins in retail business that were not fully compensated for by higher loan volumes and re-pricing of deposits. Net fee and commission income went down due to lower lending and point-of-sale maintenance fees due to the sale of the card-acquiring business in 2016. Net trading result remained stable. Operating expenses increased on the back of higher personnel and IT expenses, which was partially compensated for by lower deposit insurance contributions of EUR 0.8 million (EUR 2.5 million). Overall, operating result decreased, the cost/income ratio deteriorated. Net impairment loss on financial assets decreased mainly due to a release of provisions in the corporate business. The other result declined mainly due to the non-recurrence of last year's selling gains on the shares of VISA Europe in the amount of EUR 26.8 million. The payment into the resolution fund decreased to EUR 2.8 million (EUR 4.0 million). Banking tax amounted to EUR 27.4 million (EUR 25.1 million). Overall, the net result attributable to the owners of the parent declined.

Credit risk

Credit risk exposure in the Slovakia segment rose to EUR 17.3 billion (+10.2%). Loans to customers increased to EUR 12.0 billion (+14.2%). Slovakia was thus one of the most dynamic segments of Erste Group. Its share of Erste Group's total loan portfolio rose to 8.4% (7.8%). The breakdown of the portfolio by customer segment shows a slight shift towards corporate loans. The share of loans to private households amounted to 72.6% (73.3%) of total customer loans and was again significantly larger than in other geographical segments. This customer mix also explains the large share of secured business of 58.8% of the entire loan portfolio, which exceeds that of other Central and East European core markets. The NPL ratio declined to 3.8% (4.5%). Asset quality improved across all customer segments. The NPL coverage ratio based on loan loss provisions rose to 79.7% (72.1%).

ROMANIA

Economic review

The Romanian economy posted the fastest growth rate among Central European countries in 2017. This performance was driven by surging household consumption on the back of tax cuts and a substantial wage increase in the public sector. The unemployment rate declined further to 5.0%, the lowest level in the last 20 years. Investments also made a positive contribution to growth, mainly supported by the private sector. The good performance of the agricultural sector also played an important role.. Net exports did not contribute to economic growth, despite the robust performance of the industrial sector, including automotive. Overall, real GDP grew by 7.0%, GDP per capita amounted to EUR 9,500.

The political environment was volatile throughout 2017. The short governmental tenures limited the implementation of necessary structural reforms, especially in tax collection, public investments and EU funds absorption. The fiscal policies remained loose as the government increased wages in the public sector and cut VAT to 19%. At 3.0%, the budget deficit remained within the target of 3% of GDP. Public debt as a percentage of GDP decreased to 36.3%, a low level compared to some other countries in the region. As of the end of 2017, Standard & Poor's and Fitch had the country's long-term credit rating with a stable outlook at BBB-, Moody's, also with a stable outlook, at Baa3.

After two consecutive years of deflation, price levels started to increase in 2017. Despite the cut in VAT and lower excise duties on fuel, average consumer prices increased by 1.3%, slightly less than the national bank's target of 1.5% to 3.5%. The widening current account deficit and statements from the central bank regarding greater flexibility in foreign exchange rate control led to a weakening of the Romanian leu in the fourth quarter. The currency then traded between 4.6 and 4.7 against the euro, after a previous stable range of 4.4 and 4.5. The national bank kept its policy rate at 1.75% throughout the year but lowered the mandatory reserves for foreign exchange liabilities to 8%.

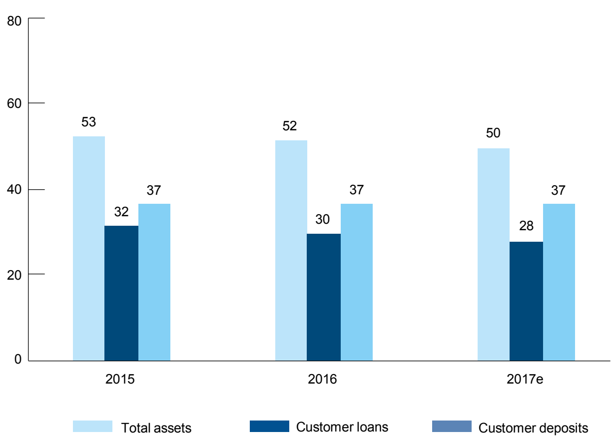
Key economic indicators – Romania	2014	2015	2016	2017e
Population (ave, million)	19.9	19.9	19.8	19.8
GDP (nominal, EUR billion)	150.3	160.3	169.8	187.5
GDP/capita (in EUR thousand)	7.5	8.1	8.6	9.5
Real GDP growth	3.1	4.0	4.8	7.0
Private consumption growth	4.4	5.7	7.3	8.8
Exports (share of GDP)	34.9	34.1	33.8	33.4
Imports (share of GDP)	38.9	39.3	39.7	40.3
Unemployment (Eurostat definition)	6.8	6.8	6.0	5.0
Consumer price inflation (ave)	1.1	-0.6	-1.5	1.3
Short term interest rate (3 months average)	2.5	1.3	0.8	1.2
EUR FX rate (ave)	4.4	4.4	4.5	4.6
EUR FX rate (eop)	4.5	4.5	4.4	4.4
Current account balance (share of GDP)	-0.7	-1.2	-2.1	-3.4
General government balance (share of GDP)	-1.4	-0.8	-3.0	-3.0

Source: Erste Group

Market review

The Romanian banking market benefitted from the macroeconomic developments and revived demand for banking products. Customer loans moved up 4.9%. In the retail segment, mortgages grew faster than consumer loans. The government-guaranteed mortgage programme Prima Casa continued to be important. In the corporate segment, lending grew mainly as a result of a pick-up in investment loans in large corporates. In addition, banks reviewed lending criteria regarding tenor and loan-to-value ratios after the initial tightening in the previous year following adoption of the walkaway law (datio in solutum). Customer deposits increased by 10.4%, mainly due to demand for current and savings accounts as a result of higher disposable income. The banking system's loan-to-deposit ratio dropped further to 76.8% at the end of 2017.

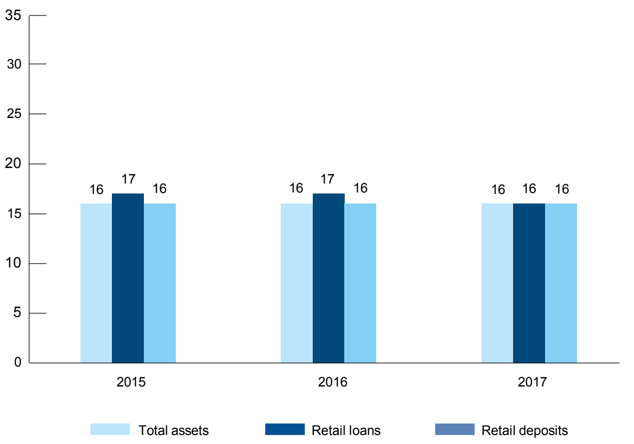
Financial intermediation – Romania (in % of GDP)



Source: National Bank of Romania, Erste Group

The profitability of the country's banking market improved, partially due to lower risk provisions. Asset quality improved, mainly driven by the continued resolution of non-performing loans as well as the positive macroeconomic backdrop such as the low interest rate environment, higher wages, and improved job market. Financial institutions continued to implement efficiency measures, including further workforce reductions, network optimisation and automation. Overall, the sector achieved a return on equity of 12.7%. The banking sector's consolidation continued as Banca Transilvania acquired Bancpost. The Romanian banking sector continued to be strongly capitalised with a total capital ratio of 18.9% at the end of the year.

Market shares – Romania (in %)



Source: National Bank of Romania, Erste Group

Banca Comercială Română remained the largest bank in the country. As of the end of 2017, the bank was ranked number one by total assets, customer loans, customer deposits and asset management. The bank defended its market leader position in Prima Casa, with a share of approximately 25%. Banca Comercială Română's customer loan market share, however, decreased to 14.1%, most visibly in the corporate sector in which the market share stood at 12.1%. The customer deposit market share remained stable at 15.7%. In terms of total assets, Banca Comercială Română had a market share of 15.8%.

Business review – Highlights

Success in retail and SME lending. The bank's leading position in mortgage lending, particularly in the Prima Casa programme and the acceleration in standard mortgage sales, drove the increase in retail loans. Micro lending started to recover, following a new service model implementation and the launch of more transactional-oriented new bundles, as well as the active participation of the bank by offering bridge loans in the state-subsidised *Start-up Nation* programme. On the back of expected interest rate increases, Banca Comercială Română promoted fixed-interest loans for both secured and unsecured loans to provide its retail customers with a higher degree of predictability and transparency, an offer which was well received by customers.

The bank also focused its lending activity on its corporate and SME business. Within the corporate loan book, working capital loans declined while investment finance increased. As a result of the bank's intensified efforts in client acquisition and activation, net loans to SME customers increased by more than 10%.

Customer satisfaction and contact center activity. Banca Comercială Română focused on increasing customer satisfaction and service excellence. In line with the new cashless branch concept, the bank started to implement a more active contact center approach. The contact center now has the role to ensure the interface between digital banking and the service in branches by offering a more relevant support in advisory as well as selling products and services. These efforts resulted in particular in a higher volume of unsecured loans and also in a higher number of current accounts opened and insurance products sold.

Innovation and digital banking. Data excellence is the basis for future growth and makes it possible to respond not only more effectively to regulatory requirements but also to customer needs. To further improve efficiency, Banca Comercială Română introduced, as the first bank in the country, the RPA (Robotic Process Automation) technology for some repetitive tasks in the back-office area.

The mobile banking offering was redesigned by adding new features. Furthermore, it is now possible to open current accounts and term deposits fully online. The number of internet banking users exceeded one million. The next step will be the implementation of *George*, which is planned for 2018.

International and local recognition. Banca Comercială Română was named the *Best Retail Bank in 2017* by the local financial magazine *Piata Financiara*. It also won the Romanian *PR Silver Award for Excellence* for the project Banking Language Understood by Everyone, the *Excellence Award of the Romanian CSR* awards for its Goodness Stock Exchange, the only free of charge donation platform in the country, and the *Best Office Lease of the Year* award for its new headquarters.

Financial review

in EUR million	2016	2017	Change
Net interest income	374.9	365.5	-2.5%
Net fee and commission income	157.9	153.4	-2.9%
Net trading result	70.3	77.3	10.0%
Operating income	615.7	611.5	-0.7%
Operating expenses	-349.8	-338.0	-3.4%
Operating result	266.0	273.5	2.8%
Cost/income ratio	56.8%	55.3%	
Net impairment loss on financial assets	62.4	-7.1	n/a
Other result	-90.7	-88.9	-2.0%
Net result attributable to owners of the parent	199.5	120.7	-39.5%
Return on allocated capital	21.6%	12.5%	

The segment analysis has been performed on a constant currency basis. The RON depreciated by 1.7% against the EUR in the reporting period. Net interest income in the Romania segment (comprising Banca Comercială Română Group) decreased mainly due to lower income from lending business and lower unwinding effects. Net fee and commission income decreased on the back of lower transaction and account maintenance fees in the retail business. The increase in net trading result was mostly attributable to foreign currency positioning and derivatives revaluation. Operating expenses decreased on the back of the significantly lower deposit insurance fund contribution of EUR 2.2 million (EUR 14.5 million). Overall, operating result increased and the cost/income ratio improved. Despite the non-recurrence of last year's high net provision releases, the net impairment loss on financial assets remained low. Other result improved due to a significantly lower level of provisions for litigations despite higher resolution fund contribution of EUR 14.2 million (EUR 4.5 million) and the non-recurrence of last year's selling gains on the shares of VISA Europe in the amount of EUR 24.3 million. Overall, the net result attributable to the owners of the parent decreased.

Credit risk

Credit risk exposure in the Romania segment was almost stable at EUR 14.1 billion (-0.1%) while loans to customers declined slightly to EUR 7.8 billion (-1.7%). This represented a share of 5.4% (5.8%) of Erste Group's total loans to customers. The decline in the loan portfolio was mainly attributable to extensive write-downs of non-performing loans. Sales in the secondary market played a much lesser role than in the previous years. The share of foreign currency loans decreased to 45.8% (49.1%) and was almost completely denominated in euro, as the state-guaranteed Prima Casa programme was initially denominated in euro. Due to the ongoing clean-up of the portfolio, the NPL ratio declined further to 8.1% (11.8%), with non-performing corporate loans down even more sharply. The breakdown by customer segment shows that asset quality was again the highest in loans to private households. The NPL coverage ratio based on loan loss provisions rose to 92.7% (85.3%).

HUNGARY

Economic review

The Hungarian economy again performed well in 2017. Economic growth was driven mainly by household consumption, which benefitted from higher consumer confidence, increasing real wages, and continued positive trends in the labour market. Despite imports growing faster than exports, Hungary maintained a positive trade balance and a significant current account surplus. Investments were positively impacted by a strong EU funds absorption rate. Industry, construction, and services performed well, while agriculture was a drag on growth. The unemployment rate declined further and stood at a record low of 4.2%, among the lowest in the European Union. Overall, the Hungarian economy grew by 4.0%, while GDP per capita increased to EUR 12,600.

The fiscal position of the country remained solid in 2017. Despite tax cuts such as lowering the employers' social security contributions and corporate income tax, the general government balance remained well within the Maastricht limits. The minimum wage was increased. These measures were to a large extent compensated by higher revenues such as additional tax receipts on the back of wage growth and the decline of interest payments and social spending. Public debt as a percentage of GDP decreased further to 72%. Rating agencies acknowledged the performance of the Hungarian economy with Standard & Poor's and Fitch upgrading the outlook from stable to positive and affirming the country's long-term rating at BBB-. Moody's rated the country's long-term credit worthiness at Baa3 with a stable outlook.

Inflation increased but remained within the national bank's target range of 2% to 4%. This development was driven mainly by higher prices for food, tobacco and alcoholic beverages, which was counterbalanced by flat energy prices. Overall, average consumer prices increased by 2.4%. The Hungarian forint was relatively stable against the euro, trading between 305 and 315 throughout the year. The National Bank continued its expansionary monetary policy and kept the base rate at a record low of 0.90% and pushed interbank interest rates (BUBOR) very close to 0%.

Key economic indicators – Hungary	2014	2015	2016	2017e
Population (ave, million)	9.9	9.9	9.8	9.8
GDP (nominal, EUR billion)	105.6	110.8	113.7	123.5
GDP/capita (in EUR thousand)	10.7	11.2	11.6	12.6
Real GDP growth	4.2	3.4	2.2	4.0
Private consumption growth	2.4	3.4	3.8	4.1
Exports (share of GDP)	87.7	90.2	89.6	89.9
Imports (share of GDP)	81.3	81.4	79.5	81.0
Unemployment (Eurostat definition)	7.7	6.8	5.1	4.2
Consumer price inflation (ave)	-0.2	-0.1	0.4	2.4
Short term interest rate (3 months average)	2.4	1.6	1.0	0.1
EUR FX rate (ave)	308.7	309.9	311.5	309.2
EUR FX rate (eop)	314.9	313.1	311.0	310.1
Current account balance (share of GDP)	1.5	3.5	6.1	3.5
General government balance (share of GDP)	-2.1	-1.6	-1.8	-2.0

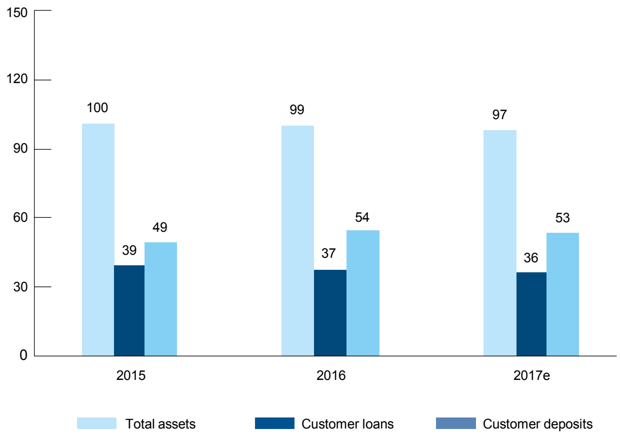
Source: Erste Group

Market review

Hungary's banking sector benefitted further from a positive macroeconomic environment and a significant improvement in business sentiment. Lending growth was stimulated primarily by economic growth and increased consumer confidence. Overall, customer loans rose by 5.2%. Growth in the retail sector was driven primarily by an increase of 3.9% in mortgage loans. In addition to the Home Purchase Subsidy Scheme for families implemented in 2015, a new consumer friendly mortgage product was introduced in 2017. These mortgage loans have standard terms defined by the National Bank of Hungary such as interest margin and mortgage fee ceilings and tenors of three, five and ten years. New disbursement growth in retail lending was substantial in 2017 but was partially offset by a high level of early repayments. Corporate loans increased by 9.8%, mainly driven by lending to SMEs. At 5.2%, customer deposits grew in line with customer loans. Similar to the lending market, the corporate deposit segment grew more quickly than the retail segment. Overall, the banking system's loan-to-deposit ratio stood at 69.0% at the end of the year.

The Hungarian banking sector remained profitable in 2017. The low interest rate environment continued to weigh on revenues. The country's banking market kept costs under control partly compensating declining revenues. Risk provisions declined substantially on the back of net provision releases and favourable macroeconomic indicators. The banking tax, calculated on the basis of total assets of 2015, was further reduced to 21 basis points. Overall, the banking sector's return on equity rose to 16.1% in 2017. Consolidation of the sector continued without changing the positions of the main market players. The Hungarian banking sector continued to be well capitalised with a capital adequacy ratio of more than 20%.

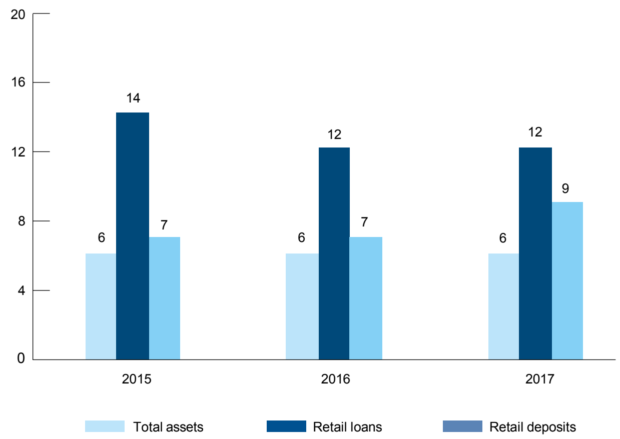
Financial intermediation – Hungary (in % of GDP)



Source: National Bank of Hungary, Erste Group

Erste Bank Hungary continued to be a major market player in the country and increased its presence further with the acquisition of Citigroup's local retail portfolio. The bank's market share for customer loans increased to 9.3% with the retail sector remaining at a higher share than the corporate sector. Customer deposit market share increased to 7.5%. Overall, Erste Bank Hungary's total assets market share increased to 5.9%.

Market shares – Hungary (in %)



Source: National Bank of Hungary, Erste Group

Business review – Highlights

Implementation of new branch model. Erste Bank Hungary started the implementation of a new branch concept. Cash desk areas are replaced by an appealing reception area in the centre of the branch. As a result of fewer administrative tasks, resources are freed up for advisory activity, leading to higher customer satisfaction.

Growth in retail and corporate lending. Erste Bank Hungary was one of the first banks, whose consumer friendly mortgage product was approved by the National Bank of Hungary. Increasing household consumption supported consumer lending growth.

The bank performed particularly well in corporate lending, increasing its net loans to corporate customers by 32.5%. Although early repayments remained relatively high, net customer loans rose by 11.1%.

International and local recognition. Erste Bank Hungary won the Randstad's *Employer Brand Research Special Award* for the most attractive employer in the banking industry in Hungary in 2017, and it ranked 3rd in the *Bank of the Year* competition.

Financial review

in EUR million	2016	2017	Change
Net interest income	173.4	198.4	14.4%
Net fee and commission income	141.8	157.4	11.0%
Net trading result	22.2	37.7	70.0%
Operating income	340.3	395.0	16.1%
Operating expenses	-195.6	-220.8	12.9%
Operating result	144.8	174.2	20.3%
Cost/income ratio	57.5%	55.9%	
Net impairment loss on financial assets	91.7	35.1	-61.7%
Other result	-93.4	-28.6	-69.4%
Net result attributable to owners of the parent	133.6	164.9	23.4%
Return on allocated capital	27.1%	29.3%	

The segment analysis has been performed on a constant currency basis. The HUF appreciated by 0.7% against the EUR in the reporting period. Net interest income in the Hungary segment (comprising Erste Bank Hungary Group) increased on the back of the acquisition of Citibank's retail portfolio (predominantly unsecured loans) and a decreased unwinding contribution. Net fee and commission income rose due to higher card, payments and securities fees in the retail business supported by the former Citibank portfolio. Net trading result improved mainly due to the higher contribution of derivatives. Operating expenses increased primarily due to additional costs related to the former Citibank business and IT expenses. The contribution to the deposit insurance fund amounted to EUR 8.7 million (EUR 7.4 million). Consequently, operating result and the cost/income ratio improved. A lower net release of risk provisions (net impairment loss on financial assets) was posted both in retail and corporate business. Other result improved on the release of provisions for litigations, higher selling gains from securities and shares in VISA Inc. and Mastercard Inc. as well as lower banking levies of EUR 55.3 million (EUR 57.0 million). This line item also included the contribution to the resolution fund of EUR 1.9 million (EUR 1.8 million). Overall, the net result attributable to the owners of the parent improved.

Credit risk
Credit risk exposure in the Hungary segment rose significantly to EUR 7.9 billion (+17.3%). After contracting for several years, loans to customers likewise registered growth, rising to EUR 3.8 billion (+8.3%). The share of the Hungary segment in Erste Group's total loans to customers was stable at 2.6%. While loans to private households were slightly down, loans to corporates increased to approximately EUR 1.6 billion (+21.6%). The share of loans denominated in Hungarian forint amounted to 75.7% (79.5%). Asset quality again improved substantially. Non-performing loans as a percentage of total loans to customers declined to 5.5% (9.7%), with the corporate business showing the sharpest reduction of the NPL ratio to 1.7% (8.9%). The NPL coverage ratio based on loan loss provisions rose significantly to 89.3% (75.0%).

CROATIA

Economic review
The Croatian economy continued to perform well in 2017. Domestic demand, in particular private consumption, remained strong and contributed significantly to the performance of the country. Consumption benefited from higher disposable income, revived credit growth, and resilient consumer sentiment. However, the restructuring of the conglomerate Agrokor, which almost became insolvent and had to be bailed out by the state, impacted spending. Investments performed well and the well-developed tourism industry had another excellent year with overnight stays expanding in mid-single digit rates. The unemployment rate declined further to 11.3%, still high compared to other countries in CEE. Overall, real GDP grew by 2.8% and GDP per capita increased to EUR 11,300.

After a period of political uncertainty, a new government was formed in June 2017. The fiscal performance improved further, revenues were to a significant degree driven by VAT and corporate income tax. Pressure on the expenditure side was largely contained partially due to lower social transfers. The general government balance stood at 0.3% and public debt as a percentage of GDP declined to 78.7%. In 2017, both Fitch and Moody's upgraded their outlook to stable, affirming the long-term credit ratings at BB+ and Ba2, respectively. Standard & Poor's upgraded the outlook to positive and affirmed the country's long-term credit rating at BB.

Inflation increased, the average consumer price rose by 1.1% and was impacted by energy price hikes and increasing food prices. The restructuring of Agrokor did not significantly impact the performance of the Croatian kuna which traded in the range of 7.4 and 7.6 against the euro. Given the country's very high use of the euro, the National Bank of Croatia's objective to preserve the nominal exchange rate stability remained in place. The National Bank of Croatia left the key policy rate unchanged at 3.0%.

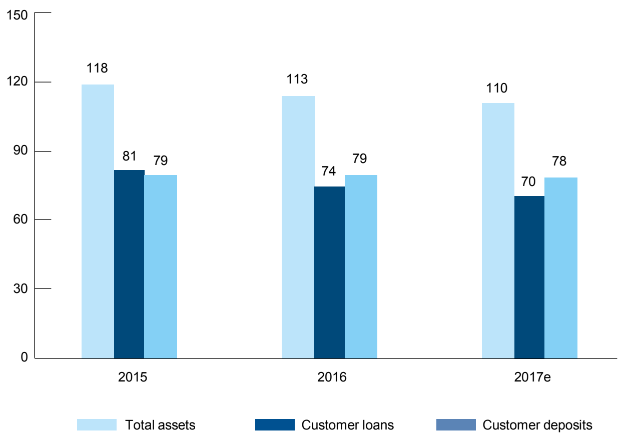
Key economic indicators – Croatia	2014	2015	2016	2017e
Population (ave, million)	4.3	4.3	4.3	4.3
GDP (nominal, EUR billion)	43.4	44.5	46.4	48.7
GDP/capita (in EUR thousand)	10.1	10.4	10.8	11.3
Real GDP growth	-0.1	2.3	3.2	2.8
Private consumption growth	-1.6	1.0	3.5	3.6
Exports (share of GDP)	21.7	22.9	22.7	24.0
Imports (share of GDP)	36.7	38.5	38.5	40.6
Unemployment (Eurostat definition)	17.3	16.3	13.1	11.3
Consumer price inflation (ave)	-0.2	-0.5	-1.1	1.1
Short term interest rate (3 months average)	0.7	1.0	0.6	0.5
EUR FX rate (ave)	7.6	7.6	7.5	7.5
EUR FX rate (eop)	7.7	7.6	7.6	7.5
Current account balance (share of GDP)	2.0	4.5	2.5	3.6
General government balance (share of GDP)	-5.1	-3.3	-0.9	0.3

Source: Erste Group

Market review

Despite favourable macroeconomic developments, Croatia's banking market suffered from relatively weak demand for banking products. The corporate sector again outperformed the retail sector in both lending and deposits. Tourism and export-related lending increased visibly. Overall, customer loans declined slightly while customer deposits increased. The system's loan-to-deposit ratio stood at 90.3% at the end of the year. With total banking assets at 110.0% of GDP, Croatia's level of financial intermediation as well as the capital adequacy of the Croatian banking system at 23.2% remained among the highest in the region.

Financial intermediation – Croatia (in % of GDP)

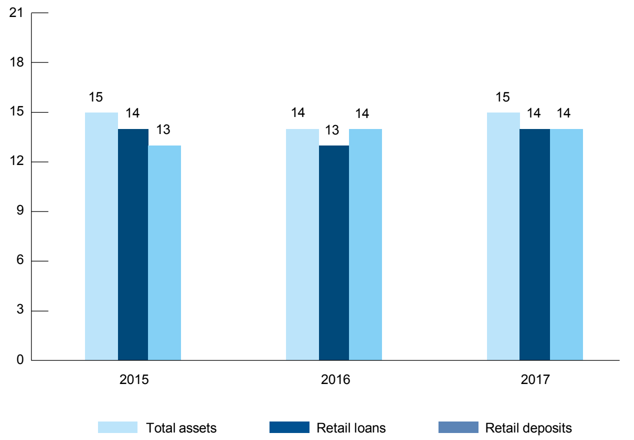


Source: National Bank of Croatia, Erste Group

Despite elevated risk provisions in the wake of Agrokor's restructuring, pressure on revenues and limited demand for banking-related products, the banking sector was profitable. The market was characterised by a visible shift towards products denominated in local currency. The banking sector's asset quality benefited from the improvement in macroeconomic developments, such as the low interest rates and decreasing unemployment. The sale of non-performing loans continued, the NPL-ratio declined further to 11.4%. Consolidation also played a role in the development of the country's banking sector. Among the transactions concluded during 2017, Hungarian OTP's acquisition of Société Générale's Splitska banka was the largest in terms of assets. Overall, the country's banking sector achieved a return on equity of 7.9%.

Erste Bank Croatia remained among the top three players in the market with a market share in terms of total assets of 14.9%. The bank outperformed the market with customer loans and customer deposits increasing by 3.5% and 5.6%, respectively. The bank's loan-to-deposit ratio stood at 97.6%.

Market shares – Croatia (in %)



Source: National Bank of Croatia, Erste Group

Business review – Highlights

Addressing SME customers. To become the bank of first choice for SME customers, Erste Bank Croatia implemented a new SME strategy. It aims at further improving customer satisfaction, increasing operational income as well as reaching an even higher level of internal efficiency.

As a result of the new strategic approach, Erste Bank Croatia acquired more than 400 new SME customers and net loans to SME customers increased by 14.6%.

Innovations in digital banking. The bank has continued its strong emphasis on digital banking. Erste Bank Croatia started to offer pre-approved loans through digital channels. The simple contracting and activation process resulted in a clear improvement in customer experience. Following a decline in 2016, net loans to customers in the retail segment increased by more than 6% due to the accelerated lending activity stemming from pre-approved loans as well as a recovery in housing loans.

International and local recognition. The bank's main strengths compared to its competitors are innovation, a wide range of products and a special emphasis on customer care. For its housing loan campaign, Erste Bank Croatia received the *Ideja X award* and for its digital media strategy for corporate clients the *MIXX award*. Erste Bank Croatia was also recognised *Best Private Bank* in Croatia in 2017 by the financial magazine *The Banker*.

Financial review

in EUR million	2016	2017	Change
Net interest income	264.9	270.5	2.1%
Net fee and commission income	88.0	95.8	8.8%
Net trading result	29.5	26.6	-9.7%
Operating income	407.4	414.0	1.6%
Operating expenses	-194.3	-206.3	6.2%
Operating result	213.1	207.7	-2.5%
Cost/income ratio	47.7%	49.8%	
Net impairment loss on financial assets	-48.4	-116.1	>100.0%
Other result	-5.2	-9.0	73.3%
Net result attributable to owners of the parent	83.7	37.7	-55.0%
Return on allocated capital	22.2%	10.4%	

The segment analysis has been performed on a constant currency basis. The HRK appreciated by 0.9% against the EUR in the reporting period. Net interest income in the Croatia segment (comprising Erste Bank Croatia Group) increased predominantly due to higher deposit margins in the retail business. Net fee and commission income went up due to higher fees from payment transfers and card transactions in retail business as well as fees related to debt issuance. The net trading result decreased on the back of lower foreign exchange and securities trading. Operating expenses increased due to higher personnel as well as IT costs and included a EUR 10.9 million (EUR 10.9 million) deposit insurance fund contribution. Overall, the operating result declined and the cost/income ratio went up. The deterioration of net impairment loss on financial assets was primarily driven by the downgrading of one customer in the corporate business. Other result deteriorated mainly due to the non-recurrence of last year's selling gains on the shares of VISA Europe in the amount of EUR 10.0 million. It included the resolution fund contribution of EUR 4.0 million (EUR 5.2 million). Consequently, the net result attributable to the owners of the parent decreased.

Credit risk

In the Croatia segment, credit risk exposure rose to EUR 9.3 billion (+3.5%). Loans to customers remained relatively stable at EUR 6.4 billion (+1.4%). The share of the Croatia segment in Erste Group's total loans to customers decreased marginally to 4.4% (4.6%). The composition of the loan portfolio by customer segment changed, with the shares of private households and corporates increasing while that of the public sector fell below 10%. The share of local currency loans rose to 31.5% (27.8%) of total loans to customers. Most loans were still denominated in euro. Since the conversion option provided by a law passed in 2015, the volume of Swiss franc denominated loans has only been marginal and, at year-end 2017, stood at EUR 63 million or 1.0% of the customer loan portfolio. The large share of foreign currency loans is mainly due to the widespread use of the euro in Croatia. Euro loans are usually matched by corresponding income or deposits in euro. Asset quality was impaired by the default of one large corporate. The NPL ratio increased to 12.3% (11.2%). The NPL coverage ratio based on loan loss provisions declined slightly to 70.9% (72.4%).

SERBIA

Economic review

The Serbian economy performed well in 2017. Economic growth, however, was weaker than expected, mainly due to lower agricultural and energy production in the first half of the year. Net exports and investments were also a drag on the economic performance. Private consumption, on the other hand, remained strong and benefitted from growing wages, increasing consumer confidence and further improvements in the labour market. The unemployment rate declined to 13.2%. Overall, real GDP grew by 1.9%, while GDP per capita stood at EUR 5,100.

Fiscal consolidation in Serbia improved further, benefitting from the stable political situation. The general government balance recorded a surplus, supported by improved tax collection and one-offs such as dividends from state-owned companies and premiums from issued securities. Public debt as a percentage of GDP improved further and reached 77.5%. Inflation increased but remained within the national bank's target range of 1.5% to 4.5%. Overall, average consumer prices increased by 3.0%. The Serbian dinar appreciated against the euro. The strong currency and improved fiscal performance led the National Bank of Serbia to cut the base rate by 50 basis points to 3.50% in 2017. Improvements in the macroeconomic development and progress of European Union membership negotiations were reflected in the actions of rating agencies in 2017 with Standard & Poor's and Fitch upgrading Serbia's long-term credit rating to BB with a stable outlook. Moody's rated the country's long-term credit worthiness at Ba3 with a stable outlook.

Key economic indicators – Serbia	2014	2015	2016	2017e
Population (ave, million)	7.2	7.2	7.2	7.2
GDP (nominal, EUR billion)	33.3	33.5	34.6	36.8
GDP/capita (in EUR thousand)	4.6	4.7	4.8	5.1
Real GDP growth	-1.8	0.8	2.8	1.8
Private consumption growth	-1.3	0.4	0.8	1.8
Exports (share of GDP)	33.4	34.9	37.0	38.9
Imports (share of GDP)	46.2	46.4	47.6	49.0
Unemployment (Eurostat definition)	19.2	17.7	15.3	13.2
Consumer price inflation (ave)	2.1	1.4	1.6	3.0
Short term interest rate (3 months average)	8.3	6.1	3.4	3.3
EUR FX rate (ave)	117.3	120.7	123.1	121.4
EUR FX rate (eop)	121.0	121.5	123.4	119.8
Current account balance (share of GDP)	-6.0	-4.8	-4.2	-4.7
General government balance (share of GDP)	-6.6	-3.7	-1.3	1.2

Source: Erste Group

Market review

The lending market, similar to the previous year, was clearly driven by retail loans which increased by 8.2%, while corporate loans fell by 1.1%. Customer deposits grew by 3.4%, driven by the corporate business. As of the end of 2017, the banking sector's loan-to-deposit ratio stood at 99.2%. Regulatory topics, such as further increase of capital buffers and harmonisation of balance sheet write-offs, also played a significant role in the development of the Serbian banking market. Serbia's banking sector remained well capitalised with the total capital ratio of 20.5%, significantly exceeding the legal requirement of 8.0%.

Financial intermediation – Serbia (in % of GDP)

Source: National Bank of Serbia, Erste Group

The profitability of the Serbian banking sector increased further. Although the declining interest rate environment resulted in margin pressure and lower net interest income, significantly lower risk provisions supported the banks' profitability. Asset quality improved mainly on the back of the low interest rate environment and the amendments in the legal framework regarding the sale of non-performing loans. At 11.1%, the NPL ratio in the retail segment continued to be significantly lower than in the corporate segment. Overall, the sector's profitability stood at 10.6% of return on equity.

Erste Bank Serbia maintained its position among the country's top ten banks. Its market share of customer loans increased further to 5.2%, retail and corporate market shares stood at 5.4% and 5.1%, respectively. The bank's deposit base remained fairly divided between euro and dinar deposits. Overall, the bank's market share for customer deposits stood at 4.6%, its loan-to-deposits-ratio at 110.1%.

Business review – Highlights

Most successful year. In terms of profitability, 2017 was the most successful year since Erste Bank Serbia launched its operations. The net result rose by one third to EUR 17.0 million, the cost/income-ratio stood at 67.3%. In addition, the continued inflow of deposits reconfirmed customers' trust in banks. Erste Bank Serbia is highly rated by its customers by all parameters of quality: trust, recommendation, satisfaction and ease of doing business with the bank.

Growing retail business. Retail loans denominated in Serbian dinars increased substantially. Thanks to efficient marketing campaigns, Erste Bank Serbia took advantage of this development despite the competitive situation on the market. The market share in retail loans increased to above 5%, and housing loans were the biggest growth contributor.

Overall, net customer loans rose by a double-digit margin. At the same time customer deposits increased by 28%, affirming the high levels of trust the bank enjoys.

International and local recognition. The bank received various awards. For its *Superste.net* platform Erste Bank Serbia received the bronze award for innovation in media by the magazine *The Internationalist*. The bank was also recognised for its contribution to the development of non-financial reporting in Serbia by the *Responsible Management Forum*.

Financial review

in EUR million	2016	2017	Change
Net interest income	46.8	51.3	9.6%
Net fee and commission income	11.1	11.3	1.7%
Net trading result	3.3	4.1	25.5%
Operating income	61.7	67.0	8.6%
Operating expenses	-40.2	-45.1	12.0%
Operating result	21.5	21.9	2.1%
Cost/income ratio	65.2%	67.3%	
Net impairment loss on financial assets	-4.1	1.2	n/a
Other result	-0.6	-0.3	-47.2%
Net result attributable to owners of the parent	12.8	17.0	32.8%
Return on allocated capital	13.6%	15.5%	

The segment analysis has been performed on a constant currency basis. The RSD appreciated by 1.4% against the EUR. Net interest income in the Serbia segment (comprising Erste Bank Serbia Group) increased mainly due to higher loan volumes. Net fee and commission income remained largely unchanged. Net trading result went up on the back of higher gains from foreign exchange transactions. The increase in operating expenses was driven by higher personnel and project costs. Operating result remained largely stable while the cost/income ratio went up. Net impairment loss on financial assets benefited from strong recovery activities as well as portfolio quality improvement mainly in corporate business, resulting in net releases of risk provisions. Overall, the net result attributable to the owners of the parent increased.

Credit risk

Credit risk exposure in the Serbia segment increased substantially to EUR 1.5 billion (+22.3%). The customer loan portfolio also saw strong growth. Loans to customers increased to EUR 965 million (+16.0%). This very dynamic development was almost exclusively attributable to the expansion of the retail business. The share of foreign-currency loans – denominated almost exclusively in euro – in the total loan portfolio stood at 78.0% (79.3%). The large share is mainly due to the widespread use of the euro in Serbia as a result of the weakness of the local currency. Euro loans are usually matched by corresponding income or deposits in euro. The clean-up of the loan portfolio by write-downs and sales as well as a decline in NPL inflows resulted in another visible improvement in asset quality. Non-performing loans as a percentage of the total loan portfolio declined to 3.3% (6.8%). The NPL coverage ratio based loan loss provisions stood at 112.0% (99.1%).

OTHER

Financial review

in EUR million	2016	2017	Change
Net interest income	129.3	105.5	-18.4%
Net fee and commission income	-43.9	-30.0	-31.8%
Net trading result	-1.7	-120.3	>100.0%
Operating income	100.9	-35.2	n/a
Operating expenses	-257.9	-269.6	4.6%
Operating result	-157.0	-304.8	94.1%
Cost/income ratio	>100.0%	>100.0%	
Net impairment loss on financial assets	-71.5	-12.6	-82.3%
Other result	-315.9	-37.5	-88.1%
Net result attributable to owners of the parent	-430.7	-256.8	-40.4%
Return on allocated capital	-6.4%	-3.0%	

Net interest income declined mainly due to a lower ALM result in the Holding on the back of an unfavourable yield curve development. Net trading result as well as result from financial assets and liabilities designated at fair value through profit or loss went down on the back of valuation effects. The increase in operating expenses was primarily driven by higher IT costs. Operating result declined. Other result improved significantly on the back of lower Austrian banking tax following a one-off payment in the amount of EUR 138.3 million in the previous year. In 2016, this line item also included partial impairment of the goodwill in Slovenská sporiteľňa in the amount of EUR 61.3 million. The net result attributable to the owners of the parent increased significantly.