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 business and geographical segments.

The tables and information below provide a brief overview and focus on selected and summarised items. For more details, please see Note 47. At www.erstegroup.com/investorrelations additional information is available in Excel format.

Operating income consists of net interest income, net fee and commission income, net trading result, gains/losses from financial instruments measured 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 three listed items are not disclosed in the tables below. Net trading result and gains/losses from financial instruments measured at fair value through profit or loss are summarised under one position. 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 impairment result from financial instruments. Impairments and provisions for commitments and guarantees given were part of other result in 2017 whereas in 2018 this line item is part of impairment result from financial instruments. Other result summarises the positions other operating result and gains/losses from financial instruments not measured at fair value through profit or loss, net. The cost/income ratio is calculated as operating expenses in relation to operating income. The return on allocated capital is defined as the net result after tax/before minorities in relation to the average allocated capital.

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 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 done with corporate customers of different turnover size (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 clients that are under the responsibility of the local corporate commercial center network, mainly consisting of companies within defined annual turnover thresholds. Local Large Corporates (LLC) are clients with specific annual turnover thresholds (lying above SME thresholds) that are not defined as Group Large Corporate customers according to the Group Large Corporate client list. Group Large Corporates (GLC) are large corporate customers/client groups with substantial operations in core mar-kets/extended core markets of Erste Group. GLC clients are included on the GLC client list. Commercial Real Estate (CRE) covers, for example, investors in real estate for the purpose of generating income from the rental of individual properties or portfolios of properties, developers of individual properties or portfolios of properties for the purpose of generating capital gains through sale. Public Sector consists of three sets of customers: public sector, public corporations and non-profit sector. In addition, a majority of municipalities are also segmented as Public Sector clients.

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 that comprise all non-core banking business activities, such as 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 economical 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	2017	2018	Change
Net interest income	2,155.7	2,267.5	5.2%
Net fee and commission income	1,003.8	1,054.4	5.0%
Net trading result and gains/losses from financial instruments at FVPL	114.0	116.3	2.0%
Operating income	3,304.4	3,467.8	4.9%
Operating expenses	-1,995.8	-2,030.9	1.8%
Operating result	1,308.6	1,436.9	9.8%
Cost/income ratio	60.4%	58.6%	
Impairment result from financial instruments	9.5	-24.7	n/a
Other result	-60.4	-52.9	-12.3%
Net result attributable to owners of the parent	960.7	1,064.9	10.8%
Return on allocated capital	40.5%	35.2%	

The increase in net interest income was driven by higher contributions from deposit business in Romania, the Czech Republic, Croatia, Slovakia and Austria as well as lending business in Croatia, Serbia and Austria. These positive developments were supported by CZK exchange rate appreciation and the higher interest rate environment in the Czech Republic and Romania. The result was negatively impacted by the change of disclosure for brokerage fee expenses in the building society. Net fee and commission income increased substantially mainly due to the shift of brokerage fee expenses to the line item net interest income in Austria as well as higher insurance and asset management fees in Slovakia and increased cards and account-related fees in Hungary. Due to higher foreign exchange income in Romania and Hungary, net trading result and gains/losses from financial instruments at FVPL improved. Operating expenses increased primarily due to higher costs in the Czech Republic driven by higher personnel expenses as well as the CZK appreciation and in Romania due to higher personnel and IT expenses. Costs in Croatia went up as well on the back of higher IT and personnel expenses. Operating result and the cost/income ratio improved. The deterioration in impairment result from financial instruments was driven primarily by higher portfolio provisioning in Romania and the Czech Republic, while risk costs in Slovakia and Serbia declined. Other result improved mainly due to release of provisions for litigation in Romania. Overall, the net result attributable to the owners of the parent increased.

Credit risk

Credit risk exposure in the Retail segment rose strongly to EUR 66.2 billion (+10.9%). The customer loan portfolio increased to EUR 56.5 billion (EUR +7.2%). The share of the retail business in Erste Group's total customer loans was up marginally at 37.0% (36.7%). The collateralisation ratio, which reflects the ratio of collateral to loan volume, stood at 64.0% (63.0%). The quality of the retail customer loan portfolio improved again. Non-performing loans declined by EUR 132 million and, as a percentage of total retail customer loans, decreased to 2.8% (3.2%). In terms of the NPL ratio (non-performing loans as a percentage of total loans) the Retail segment thus continued to feature the highest quality of all business segments with a significant loan portfolio. After a change in the method used for allocating risk positions to risk categories, low-risk loans as a percentage of total retail customer loans amounted to 81.5% (86.3%). The NPL coverage ratio based on loan loss provisions rose to 84.0% (78.0%).

CORPORATES

Financial review

in EUR million	2017	2018	Change
Net interest income	993.9	1,032.2	3.9%
Net fee and commission income	256.2	283.1	10.5%
Net trading result and gains/losses from financial instruments at FVPL	93.4	88.2	-5.5%
Operating income	1,469.9	1,524.0	3.7%
Operating expenses	-577.0	-572.3	-0.8%
Operating result	892.9	951.8	6.6%
Cost/income ratio	39.3%	37.5%	
Impairment result from financial instruments	-135.3	59.4	n/a
Other result	-13.9	7.1	n/a
Net result attributable to owners of the parent	580.3	801.5	38.1%
Return on allocated capital	18.8%	21.0%	

Net interest income increased primarily due to higher loan volumes and deposit margins in the Czech Republic, supported by CZK appreciation and a higher interest rate environment, as well as higher contribution of lending business in Slovakia and Erste Bank Oesterreich. These effects were partially offset by the lower contribution of lending business in the Holding. A better result from supply chain financing and higher documentary business fees in the Holding largely contributed to the increased net fee and commission income. Fee income in Slovakia and Romania increased as well. Net trading result and gains/losses from financial instruments at FVPL decreased as a result of positive valuation effects in 2017 of a portfolio migrated in 2018 from the corporate business to ALM in Erste Bank Oesterreich as well as higher income from hedging activities in the Czech Republic in 2017. Overall, operating income improved. Moderately reduced operating expenses further contributed to the improvement in operating result and the cost income ratio. The net release of risk provisions (line item impairment result from financial instruments) resulted from improved quality of the loan portfolio, lower default rates, higher recoveries as well as releases of specific provisions. The biggest improvement was posted in Croatia and Austria. Other result improved partly due to the changed off-balance risk provisions disclosure (allocations posted in 2017 were part of the line item other result). The net result attributable to the owners of the parent increased notably.

Credit risk

Credit risk exposure in the Corporates segment rose to EUR 70.6 billion (+10.9%). At the same time, loans to customers increased to EUR 50.1 billion (+6.1%). As a percentage of Erste Group's total loans to customers, they were nearly unchanged at 32.8% (32.9%). The difference between credit risk exposure and the customer loan portfolio in the Corporates segment is primarily due to a large volume of guarantees and unused loan commitments. Active management of non-performing loans by restructuring and write-downs again resulted in a significant improvement of asset quality in the Corporates segment. Sales of non-performing loans were at the level of 2017 and played a significantly lesser role than in previous years. The NPL ratio dropped substantially to 3.4% (4.9%). The NPL coverage ratio based on loan loss provisions rose to 73.0% (69.4%).

GROUP MARKETS

Financial review

in EUR million	2017	2018	Change
Net interest income	196.8	252.6	28.3%
Net fee and commission income	223.0	226.5	1.6%
Net trading result and gains/losses from financial instruments at FVPL	133.0	53.1	-60.1%
Operating income	554.1	533.7	-3.7%
Operating expenses	-229.5	-241.3	5.2%
Operating result	324.6	292.4	-9.9%
Cost/income ratio	41.4%	45.2%	
Impairment result from financial instruments	3.6	-0.4	n/a
Other result	-11.5	-21.3	84.5%
Net result attributable to owners of the parent	245.7	215.7	-12.2%
Return on allocated capital	36.9%	27.4%	

Net interest income increased primarily due to the increased volumes of reverse repo business in the Czech Republic and Austria. Net fee and commission income rose mainly due to the higher asset management and depository services fees in the Czech Republic. Net trading result and gains/losses from financial instruments at FVPL decreased due to last year´s extraordinarily favourable market conditions for interest rate related products and lower valuation results of securities. Consequently, operating income declined. Operating expenses went up on the back of higher IT and project-related costs. Operating result thus declined, and the cost/income ratio deteriorated. Other result slipped primarily due to higher payments into resolution funds and banking taxes. Overall, the net result attributable to the owners of the parent decreased.

ASSET/LIABILITY MANAGEMENT & LOCAL CORPORATE CENTER

Financial review

in EUR million	2017	2018	Change
Net interest income	-55.4	-91.6	65.4%
Net fee and commission income	-87.4	-102.8	17.7%
Net trading result and gains/losses from financial instruments at FVPL	-97.7	-32.1	-67.1%
Operating income	-191.2	-178.5	-6.6%
Operating expenses	-86.0	-67.8	-21.2%
Operating result	-277.2	-246.3	-11.1%
Cost/income ratio	-45.0%	-38.0%	
Impairment result from financial instruments	-8.3	12.4	n/a
Other result	-142.9	-131.2	-8.1%
Net result attributable to owners of the parent	-359.3	-289.1	-19.5%
Return on allocated capital	-17.7%	-10.6%	

Net interest income decreased primarily due lower contribution from balance sheet management in Romania, Croatia and the Holding that was partially compensated by increased interest rates in the Czech Republic. Net fee and commission income decreased mainly due to lower payment fees in Slovakia and Romania. Net trading result and gains/losses from financial instruments at FVPL improved due to valuation results in the Holding. Operating expenses declined due to a changed cost allocation in Erste Group Immorent, Erste Bank Oesterreich and Czech Republic, resulting in a shift to the Retail and Corporate Segments. Overall, operating result improved. Other result improved mainly due to releases of provisions for litigation in Erste Group Immorent. These effects were partially offset by the non-recurrence of the selling gains from bonds in the Czech Republic, Hungary and the Holding. The net result attributable to the owners of the parent improved.

SAVINGS BANKS

Financial review

in EUR million	2017	2018	Change
Net interest income	982.0	1,016.4	3.5%
Net fee and commission income	446.2	459.8	3.0%
Net trading result and gains/losses from financial instruments at FVPL	10.2	-27.1	n/a
Operating income	1,492.9	1,497.4	0.3%
Operating expenses	-1,051.2	-1,073.3	2.1%
Operating result	441.7	424.1	-4.0%
Cost/income ratio	70.4%	71.7%	
Impairment result from financial instruments	12.6	19.8	57.5%
Other result	-38.0	-4.5	-88.1%
Net result attributable to owners of the parent	51.9	53.6	3.1%
Return on allocated capital	14.7%	12.2%	

The increase in net interest income was primarily attributable to higher customer loan volumes. Net fee and commission income increased on the back of higher lending and payment fees. The deterioration of net trading result and gains/losses from financial instruments at FVPL was driven by valuation effects. Operating expenses rose due to increased personnel expenses. Deposit insurance contributions amounted to EUR 27.9 million (EUR 27.0 million). Operating result thus decreased, and the cost/income ratio deteriorated. A higher net release of risk provisions was reflected in the impairment result from financial instruments. Other result improved due to the non-recurrence of the provisions for expected losses from customer loans due to supreme court rulings regarding negative interest reference rates in 2017 (EUR 31.3 million) as well as changed disclosure of provisions for off-balance exposure, which were partially offset by the non-recurrence of selling gains from bonds. Payments into the resolution fund increased to EUR 9.0 million (EUR 6.4 million). Banking tax amounted to EUR 4.0 million (EUR 4.4 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 63.5 billion (+10.1%), while loans to customers rose to EUR 44.6 billion (+6.0%). Their share in Erste Group's total customer loans was nearly unchanged at 29.2% (29.4%). Lending to private households showed above-average growth, raising its share in the Savings Banks' total customer loan portfolio to 39.0% (38.3%). Loans to professionals, other self-employed persons and small businesses stagnated at EUR 6.6 billion. At 14.8% (15.7%) of total loans, the share of this customer segment was again extraordinarily large and, most notably, 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 2.0 billion (- 10.0%). The trend towards higher collateralisation of loans continued. Non-performing loans as a percentage of total loans to customers decreased to 3.6% (4.2%). The development was especially positive among corporate clients. The NPL coverage ratio based on loan loss provisions rose to 61.2% (58.3%).

GROUP CORPORATE CENTER

Financial Review

in EUR million	2017	2018	Change
Net interest income	74.9	77.9	4.0%
Net fee and commission income	13.0	-12.5	n/a
Net trading result and gains/losses from financial instruments at FVPL	-41.5	39.9	n/a
Operating income	73.1	124.2	69.9%
Operating expenses	-996.4	-980.4	-1.6%
Operating result	-923.3	-856.2	-7.3%
Cost/income ratio	>100.0%	>100.0%	
Impairment result from financial instruments	-14.1	-7.3	-48.5%
Other result	709.2	636.0	-10.3%
Net result attributable to owners of the parent	-163.2	-53.0	-67.5%
Return on allocated capital	-2.0%	-0.8%	

Operating income increased mainly due to improved net trading result and gains/losses from financial instruments measured at FVPL driven by positive valuation effects in the Holding. As operating expenses declined, operating result improved. Other result went down on the non-recurrence of last year's selling gains. Overall the net result attributable to the owners of the parent improved.

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 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 GmbH, Erste Asset Management GmbH and Intermarket Bank AG.

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 economical 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

Austria is a well-diversified, developed and open economy, benefitting from a high value adding industrial base, an educated workforce and a strong tourism and service sector. In 2018, economic growth was better than expected on the back of strong domestic demand, in particular exceptionally strong consumer spending. Growth in investment spending remained robust, and exports accelerated significantly. In addition, the service sector, in particular tourism, continued to perform well. With 150 million overnight stays, tourism reached a new record. The robust economic activity resulted in a decline of the unemployment rate to 4.9% and improved for the second consecutive year. In terms of GDP per capita, at EUR 44,000, Austria remained one of the wealthiest countries in the euro zone. Overall, real GDP grew by 2.7%.

The favourable economic performance led to a further improvement of the general government deficit to 0.3%. This positive development was mainly due to higher-than-expected revenues from personal and corporate income taxes. Government expenditure as a percentage of GDP fell in 2018, mainly due to declining interest payments and lower unemployment benefits. Public debt as a percentage of GDP also decreased further to 74.2%.

At 2.1%, average consumer price inflation remained well under control. Core inflation, which represents price development excluding food and energy prices, amounted to 1.8%. Public and private sector wages increased by 2.4%, resulting in real wage growth. The European Central Bank slightly moderated its extremely expansionary monetary policy by reducing bond purchases but at the same time leaving its key deposit interest rate in negative territory, at -0.4%. At year-end, Standard & Poor's and Moody's had the country's long-term credit rating with a stable outlook at AA+ and Aa1, respectively. Fitch upgraded the outlook to positive and confirmed the rating at AA+.

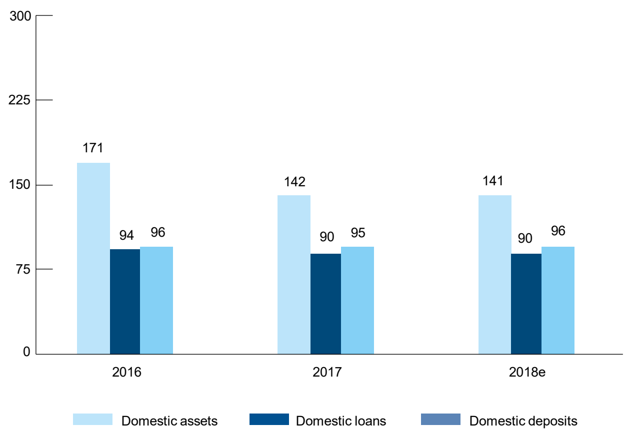
Key economic indicators – Austria	2015	2016	2017	2018e
Population (ave, million)	8.6	8.7	8.8	8.8
GDP (nominal, EUR billion)	344.5	353.3	369.9	386.1
GDP/capita (in EUR thousand)	39.9	40.4	42.1	43.7
Real GDP growth	1.1	2.0	2.6	2.7
Private consumption growth	0.5	1.5	1.4	1.7
Exports (share of GDP)	39.7	39.8	41.1	42.0
Imports (share of GDP)	41.2	4.2	43.0	43.3
Unemployment (Eurostat definition)	5.7	6.0	5.5	4.9
Consumer price inflation (ave)	0.8	1.0	2.2	2.1
Short term interest rate (3 months average)	0.0	-0.3	-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)	1.9	2.1	2.0	2.3
General government balance (share of GDP)	-1.0	-1.6	-0.8	-0.3

Source: Erste Group

Market review

The Austrian banking market, with total assets of 221.4% of GDP, is a highly competitive and developed market. It continued to be characterised by significantly lower margins than in Central and Eastern Europe and, like all other markets Erste Group operates in, benefitted from low risk costs. The Financial Markets Authority (FMA) had already introduced a systemic risk buffer for a number of Austrian credit institutions and a buffer for other systemically important institutions in December 2015. For Erste Group, the buffer amounted to 1% of risk-weighted assets as of 1 January 2018. As of 1 January 2019, the buffer increased to 2%.

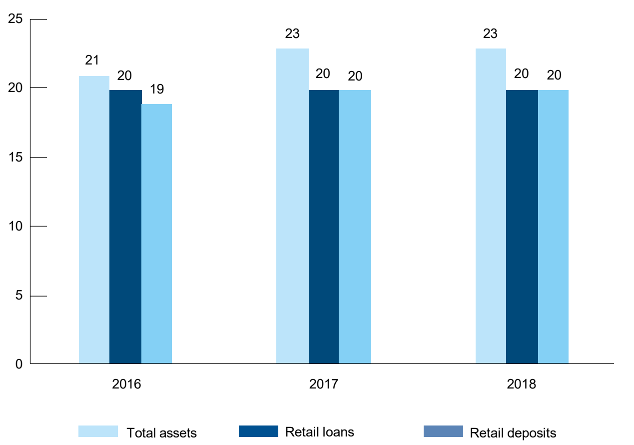
Financial intermediation – Austria (in % of GDP)



Source: Oesterreichische Nationalbank, Erste Group

Driven by the strong macroeconomic performance, customer loans increased by 4.4%. Both retail and corporate lending rose considerably. Customer deposits grew more than loans, and the banking system's loan-to deposit-ratio ratio stood at 94.4% at the end of the year. The banking tax remained nearly unchanged at EUR 226 million in 2018. On the back of loan growth coupled with low risk costs, the banking system's profitability improved to a return on equity of 9.9%. Capitalisation of the banking system also improved further in 2018.

Market shares – Austria (in %)



Source: Oesterreichische Nationalbank, Erste Group

Digitalisation remained pivotal for the Austrian financial sector. In 2018, the first entirely blockchain-based capital markets issuance in Europe was successfully launched. A blockchain-based process offers improved speed, lower operational risk and greater transparency. Financial digital services and products have continuously been improved and customer engagement increased further – approximately 60% of the Austrian banking customers are now actively using digital banking products and services.

The three largest banking groups kept a combined market share of approximately 60% in customer loans and deposits. Erste Bank Oesterreich and the savings banks succeeded in further increasing their combined market shares to between 20% and 22% in both retail and corporate business, benefitting from their balanced business model. In terms of total assets, their combined market share stood at 23.1% at year-end. George, the digital banking platform developed by Erste Group's in-house fintech, has defended its position as the country's most modern and popular banking platform. Its 1.7 million users in the country represent more than every third online banking user in Austria.

ERSTE BANK OESTERREICH & SUBSIDIARIES

Business review 2018 – three questions to the CEO of Erste Bank Oesterreich, Stefan Dörfler

How did the competitive environment change? The competitive environment remained challenging throughout the year, driven by the macro, regulatory and competitive backgrounds.

On the retail side, banks further reduced their regional footprint, particularly larger market participants focused their measures on urban areas. Business has become increasingly digital, main competitors are gradually building up their digital product offering through revamped online banking platforms, as well as offering consumer finance and asset management products online. So far, we have not recognised any disruptive activities by tech companies nor by fintechs. At the same time, some of the mid-sized competitors continued to expand out of their regional home markets into urban areas in Austria as well as into neighbouring countries. Overall, digital adoption rates remained quite low, but growth is high, and building a consistent multi-channel service platform will be a core challenge for all retail banks in Austria.

Corporate business again has seen fierce price-based competition on the lending side, driven by the low interest rate environment, high liquidity levels of banks and favourable development of corporate clients' risk profiles. Full product coverage of corporate clients remains the key asset to ensure sustainable and profitable client relationships.

In addition, cost will remain a core issue for all banks in the market, especially in view of current wage pressure driven by strong economic growth as well as increasing regulatory expenses.

Considering the strategic focus of your bank, what did you do differently compared to the past? Continuously expanding our customer base, improving customer experience and staying ahead of the competition in retail will be achieved by further focusing on our key priority of building a seamless omni-channel product offering for our clients. Major focus areas were the expansion of our digital product offering by launching the *klickkredit*. We strongly believe that building a digital presence is a key driver next to establishing a strong brand and striving for service excellence, in both, our digital and analogue channels.

Corporate business remains one of our core growth potentials, we focus on tailor-made client solutions and coverage models, whilst building a state of the art product and service offering.

Transforming our bank, exploring new ways of doing business, growing our portfolios and focusing on the cost development requires permanent attention to our processes. We are gradually transforming the way we work together, cross-functional teams committed to the clients' needs are getting more and more important.

Looking back at the year, what were the major challenges and key achievements? In retail we expanded our digital service offering by introducing an all online consumer finance product, managed to be the first bank in Austria to offer our clients multi-banking capability in our George platform and increased the number of overall clients.

Corporate has seen the introduction of our new online platform *Telebanking Pro*, allowing our customers not only to fulfil day-to-day banking and cash management needs. It will also be enhanced to serve as a platform for related party service offerings.

One major activity was the re-positioning of our brand advertising in line with the #believeinyourself theme. The positive feedback we received reassures us that we are on the right track in spreading our message to customers and the general public.

In addition, we continued to challenge our internal client-facing as well as non-client-facing processes and structures in an effort to optimise cost development. This entailed among other things the re-design of our retail mortgage lending process and the enhancement of our call center operations.

Business review – Additional question on cooperation with the savings banks

How did cooperation with the savings banks develop and what were the major achievements in this area? We again gained a large number of new clients in 2018 and increased our market share in lending. This was largely attributable to our strong regional presence. To further strengthen our market position, we are working with the savings banks to develop a new user interface that enables sales staff to discuss customer needs more individually in face-to-face talks as well as across all channels. The aim is to achieve even greater customer satisfaction.

In our operations we managed to get IT costs better under control. We have also made great progress in improving the customer experience. In the past, the savings banks had considerable freedom in developing and designing new products. We have now agreed on a range of harmonised products. As a result, new retail business is done almost exclusively with these standard products. The harmonisation of products for corporate clients has likewise been started already. We regard this important move towards harmonisation as a key prerequisite for process harmonisation. It enables us to process transactions in accordance with high quality standards while keeping processing time short to ensure better customer experience.

Financial review

in EUR million	2017	2018	Change
Net interest income	631.2	644.3	2.1%
Net fee and commission income	353.8	386.4	9.2%
Net trading result and gains/losses from financial instruments at FVPL	20.1	10.6	-47.6%
Operating income	1,053.7	1,088.1	3.3%
Operating expenses	-679.6	-678.9	-0.1%
Operating result	374.1	409.2	9.4%
Cost/income ratio	64.5%	62.4%	
Impairment result from financial instruments	26.1	14.3	-45.4%
Other result	-27.5	-39.6	44.1%
Net result attributable to owners of the parent	253.2	278.2	9.9%
Return on allocated capital	21.1%	18.7%	

Net interest income increased due to higher loan and deposit volumes in combination with stable margins that offset the negative impact from a change of disclosure for brokerage fee expenses in the building society. Net fee and commission income increased substantially mainly due to the shift of brokerage fee expenses to the line item net interest income as well as higher payment fees, which was partially offset by lower securities fees. The deterioration of net trading result and gains/losses from financial instruments at FVPL was driven by valuation effects. Despite higher deposit insurance contributions of EUR 23.3 million (EUR 21.7 million), operating expenses remained stable. Operating result thus increased, and the cost/income ratio improved. A lower net release of risk provisions (reflected in the impairment result from financial instruments) was mainly driven by corporate business. The worsening of other result was due to higher provisions for legal expenses. The payment into the resolution fund increased to EUR 10.2 million (EUR 6.1 million). Banking tax amounted to EUR 3.5 million (EUR 3.3 million). Overall, the net result attributable to the owners of the parent improved.

Credit risk

Credit risk exposure in the Erste Bank Oesterreich & Subsidiaries segment rose to EUR 43.3 billion (+10.1%), while the volume of customer loans increased to EUR 33.3 billion (+4.6%). The share of this segment in Erste Group's total loan portfolio declined to 21.8% (22.1%). The share of retail customers in total loan volume was unchanged at 39.9%. The share of corporates, including self-employed individuals and small businesses, was slightly down at 53.4% (53.8%). Loans to professionals, other self-employed persons and small businesses are less significant than they are for other Austrian savings banks and amounted to 10.0% (10.1%) of total loans to customers. Lending to the public sector showed the most dynamic growth and rose to EUR 2.2 billion (+10.6%). Owing to the ongoing campaign promoting the conversion of foreign-currency loans to euro, the share of Swiss franc denominated loans in the total loan portfolio decreased further to 4.4% (5.0%). The quality of the loan portfolio improved again. While low-risk loans grew at a rate of 4.2%, non-performing loans as a percentage of total loans to customers declined to 1.8% (2.0%). 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 segments. The NPL coverage ratio based on loan loss provisions rose markedly to 61.3% (57.1%).

SAVINGS BANKS

The geographical segment Savings Banks is identical to the business segment Savings Banks (see page 28).

OTHER AUSTRIA

Business review 2018 – three questions to the board member responsible for Corporates and Markets, Jozef Síkela

How did the competitive environment change? Overall, we have seen good development in 2018, mainly as a result of the good economic performance and the clean-up of NPL portfolios of banks in CEE, allowing banks to expand their loan portfolio. Consolidation continued with some banks being active in acquisitions while others were withdrawing. Business-wise, pricing is still under pressure (especially in plain vanilla lending). In all our core countries the growth environment was characterised by an increasing GDP.

Considering the strategic focus of your bank, what did you do differently compared to the past? Over the past years, our efforts have been on further strengthening relationships with our customers and on acquiring additional customers. Our focus was on small and medium-sized enterprises and aligned with our SME strategy to provide best in class customer experience. Through small tickets lending, we continued to develop our service and product offering to address additional customer groups. Importantly, we simplified our product offering, increased the efficiency of processes and shortened decision times.

To ensure consistent service coverage for our Large Corporate customers in the CEE region, we focus on the continuous development of the sales force, strengthening the industry specialisation and further rolling out of the parent/local account manager cooperation model. In addition, we emphasised on offering treasury products based on the customers' individual needs. In cooperation with the Corporate and Retail business, we made the first steps to provide treasury products through our digital channels such as George or Telebanking Pro. We invested further into our business system landscape to meet changing demand.

Looking back at the year, what were the major challenges and key achievements? We ucceeded in increasing our customer base by roughly 3,000 new SME customers group-wide. Client onboarding, including cross-border onboarding, was further simplified, resulting in a significant reduction of the documentation process.

We again demonstrated our syndicated loan capability domestically and internationally. The acquisition finance of approximately EUR 3 billion for PPF Group to create a significant telecom company in CEE represents the largest loan syndication in our region since 2011. For Erste Group, the transaction was the largest corporate underwriting ever.

Digital transformation has remained one of the key success factors. We saw the first blockchain-based trade finance transaction with Lenzing on the newly developed trade platform *we.trade*, a key milestone in this area. In addition, we launched Europe's first entirely blockchain-based capital markets issuance for Asfinag, the first paperless issue of a Schuldschein transaction.

We continued to provide excellent services to our customers and maintained profitability at a high level. We positioned ourselves as a strong and reliable partner for Austrian and CEE banks as well as non-bank financial institution issuers in many transactions across asset classes. As a result, Erste Group achieved the number 1 league table position as book runner in Austria and the CEE region in 2018.

Financial review

in EUR million	2017	2018	Change
Net interest income	372.2	388.9	4.5%
Net fee and commission income	216.6	224.6	3.7%
Net trading result and gains/losses from financial instruments at FVPL	59.9	-26.2	n/a
Operating income	708.0	648.3	-8.4%
Operating expenses	-373.8	-369.4	-1.2%
Operating result	334.2	278.9	-16.6%
Cost/income ratio	52.8%	57.0%	
Impairment result from financial instruments	-40.0	87.7	n/a
Other result	3.4	25.9	>100.0%
Net result attributable to owners of the parent	228.6	313.2	37.0%
Return on allocated capital	15.5%	17.7%	

Net interest income increased on higher volumes of reverse repo business in Group Markets, partially offset by lower lending margins in corporate business. Net fee and commission income increased due to higher supply chain financing and documentary business. The decrease of net trading result and gains/losses from financial instruments at FVPL was predominantly caused by last year´s extraordinarily favourable market conditions for interest rate related products in Group Markets business and by a weaker valuation result, partially compensated by selling gains from securities. Although operating expenses declined moderately, operating result decreased and the cost/income ratio deteriorated. Impairment result from financial instruments improved markedly as a result of provision releases, while the previous year included provisions for the downgrading of selected corporate customers. Other result improved mostly due to releases of litigation provisions, partially off-set by increased impairments of non-financial assets. Other result also included the resolution fund contribution of EUR 6.1 million (EUR 3.6 million). Overall, the net result attributable to the owners of the parent improved.

Credit risk

After credit risk exposure in the Other Austria segment, which is almost completely made up of Erste Group Bank AG and Erste Group Immorent GmbH, had fallen for several years, the trend reversed in 2018, raising it to EUR 31.1 billion (+7.9%). At 12.2% (12.7%), however, its share in Erste Group's credit risk exposure still declined. 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 2018, it decreased to 8.8% (9.1%). While commercial real estate financing declined further to EUR 3.0 billion (-11.2%), loans to large corporates increased. Extensive portfolio clean-up through sales of loans and, most importantly, write-downs, reduced the share of non-performing loans in the total loan portfolio significantly to 3.3% (5.6%). Within the category of performing loans, the share of low-risk loans rose substantially. The NPL coverage ratio based on loan loss provisions increased to 56.1% (50.2%).

Central and Eastern Europe

CZECH REPUBLIC

Economic review

The Czech Republic continued to perform well in 2018, posting real GDP growth of 3.0%. GDP per capita rose to EUR 19,600. Although the Czech Republic is among the most open economies in the region, growth in 2018 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. Net exports, on the other hand, did not contribute to economic growth mainly due to high imports for consumption and investment purposes. Industrial production benefitted significantly from the strong performance of the automotive industry. Czech passenger car production increased by 1.7% to more than 1.4 million vehicles. Reflecting the strong economic performance, the unemployment rate decreased further to 2.4%, and remained the lowest in the European Union.

Following parliamentary elections in late 2017, a coalition agreement between the ANO movement and the Social Democrats was reached in July 2018. Fiscal prudence prevailed as expressed by a budget surplus of 1.5%. State revenues were positively impacted by growing tax income due to measures addressing tax avoidance and higher social contributions. These developments offset the significant increase of public wages and pensions. Public debt as a percentage of GDP was again one of the lowest in Central and Eastern Europe at 33.2%.

Despite rising domestic demand and higher wages, inflation slightly decreased and remained within the Czech National Bank's range of 1-3%. The Czech koruna appreciated versus 2017, although to a lesser degree than initially expected, as five rate hikes by the Czech National Bank were not enough to offset increased market volatility during the course of the year. Average consumer price inflation amounted to 2.2%.

These economic developments were also acknowledged by Fitch, which upgraded the country's long term credit rating to AA- with a stable outlook and by Moody's, which maintained its A1 rating but changed the outlook to positive. Standard & Poor's kept its AA rating with a stable outlook throughout 2018.

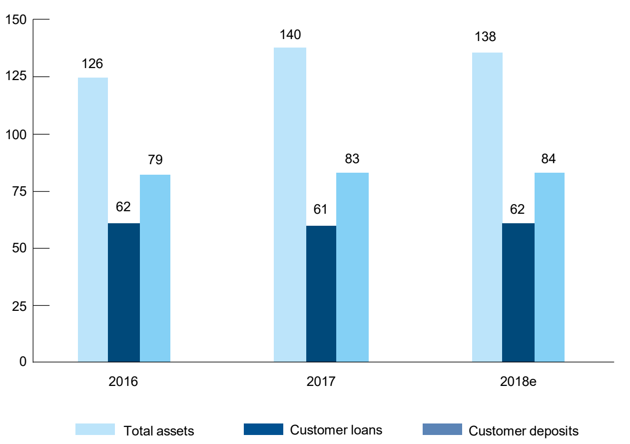
Key economic indicators – Czech Republic	2015	2016	2017	2018e
Population (ave, million)	10.5	10.6	10.6	10.6
GDP (nominal, EUR billion)	168.5	176.5	191.9	207.2
GDP/capita (in EUR thousand)	16.0	16.7	18.2	19.6
Real GDP growth	5.4	2.4	4.5	3.0
Private consumption growth	3.8	3.5	4.4	3.5
Exports (share of GDP)	74.8	75.2	76.1	75.3
Imports (share of GDP)	70.0	69.5	69.5	69.7
Unemployment (Eurostat definition)	4.5	3.6	2.4	2.4
Consumer price inflation (ave)	0.4	0.7	2.4	2.2
Short term interest rate (3 months average)	0.3	0.3	0.4	1.3
EUR FX rate (ave)	27.3	27.0	26.3	25.6
EUR FX rate (eop)	27.0	27.0	25.5	25.7
Current account balance (share of GDP)	0.2	1.6	1.1	0.6
General government balance (share of GDP)	-0.6	0.7	1.5	1.5

Source: Erste Group

Market review

The Czech banking sector continued to be very successful. The market significantly benefitted from the positive macroeconomic environment and consequently displayed strong demand for banking products. Lending growth was attributable to both retail and corporate loans. Overall, customer loans grew by 7.2%. Customer deposits increased by 6.6%, mainly driven by retail deposits. The Czech banking market remained one of the most liquid in Central and Eastern Europe. At year-end, the loan-to-deposit ratio across the banking sector stood at 74.4%. The solid fundamentals were also demonstrated by the banking sector's total capital ratio of 19.6%. Moneta Money Bank announced to acquire Air Bank and part of Home Credit in the Czech Republic and Slovakia. The transaction (which would have created the fifth biggest bank by total assets in the country) was not approved by the shareholders in early 2019.

Financial intermediation – Czech Republic (in % of GDP)

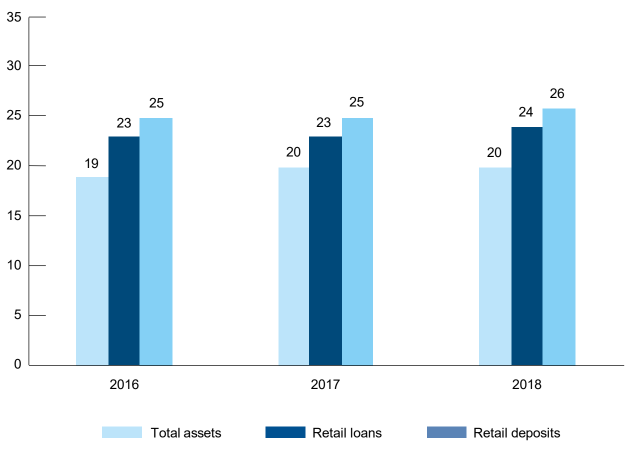


Source: Czech National Bank, Erste Group

The Czech banking sector achieved the best financial results in the last ten years. Benefiting from healthy loan growth, higher interest rates, and very low risk provisions, the sector's net profit reached EUR 3.2 billion in 2018. The share of non-performing loans decreased further to 2.3% in the retail and to 3.6% in the corporate business. Regulatory topics played a significant role in the development of the Czech banking market throughout the year. The Czech National Bank further increased the countercyclical capital buffer from 1.0% to 1.75% as of January 2020 and set stricter lending rules on secured loans, such as loan to value, debt to income, and debt service to income ratios. The stress tests performed by the central bank on the biggest players on the Czech banking market, representing 76% of the assets in the banking sector proved that Czech banks remain resilient to adverse economic conditions.

The three largest banks have a combined market share of approximately 60% in customer loans and deposits. 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%. The bank also retained its top position in consumer lending, including the credit card business, with a market share of 28.0%. Česká spořitelna further strengthened its strong position in asset management products, with a market share of 27.3%, the highest in the country. Overall, its market share in terms of total assets stood at 20.3%.

Market shares – Czech Republic (in %)



Source: Czech National Bank, Erste Group

Business review 2018 – three questions to the CEO of Česká spořitelna, Tomáš Salomon

How did the competitive environment change? It's clear that in many fields, including financial and banking markets, things accelerated, with more players and fewer barriers to entry. Innovations introduced more recently are being adopted more quickly. Consequently, customers' expectations are also rising — they want the opportunity to benefit as soon as possible from the rapid progress of new technologies. As a result, banks have to move quickly to capture those opportunities.

This trend received another boost after the PSD2 (payment services directive) regulation came into force in January 2018. As a result, our banking market opened to even more players. We saw this as an opportunity to move forward by cooperating with fintech companies on new solutions as well as providing relevant advisory services to our customers and effective guidance for prosperity.

Considering the strategic focus of your bank, what did you do differently compared to the past? We strongly emphasised data mining and data utilisation, as we had access to a substantial set of data but couldn't utilise the entire potential for the benefit of our customers. Through better data utilisation, we intend to improve the advisory services of our sales staff and the services incorporated into our digital platform George.

To reflect the fast developing market conditions, we also began changing our organisational structure and culture. Our ultimate goal is to build up a dynamic and flexible organisation that is not only capable of responding to market trends but can also anticipate the changes and development of customers' expectations.

Looking back at the year, what were the major challenges and key achievements? Most segments performed quite strongly and delivered impressive results. We outperformed the market and grew quickly in both retail and corporate loans. In investment products, Česká spořitelna boosted its position as undisputed market leader in mutual funds.

With our My Healthy Finances strategic service, we added value to the services for our customers. At year-end, more than one million customers have subscribed to this additional service Also worth mentioning is our effort to modernise the branch network. We refurbished over 50 branches in 2018 to the new format that better supports the role of branches as advisory centers. In addition, we migrated almost 1.5 million customers to the new digital platform George, making it the biggest internet banking migration in the history of the Czech banking market.

Česká spořitelna's outstanding performance in 2018 earned recognition also in prestigious banking competitions. For the first time ever, Česká spořitelna was named the Bank of the Year in a competition held by the leading business daily Hospodářské noviny. On top of that, our bank won the annual Bank of the Year poll of leading banking experts, business leaders and academics.

Financial review

in EUR million	2017	2018	Change
Net interest income	942.3	1,062.2	12.7%
Net fee and commission income	334.4	332.9	-0.4%
Net trading result and gains/losses from financial instruments at FVPL	103.6	92.5	-10.7%
Operating income	1,393.4	1,501.4	7.8%
Operating expenses	-692.8	-714.5	3.1%
Operating result	700.6	786.9	12.3%
Cost/income ratio	49.7%	47.6%	
Impairment result from financial instruments	-1.3	-11.2	>100.0%
Other result	-35.2	-49.5	40.7%
Net result attributable to owners of the parent	532.9	582.8	9.4%
Return on allocated capital	26.3%	23.4%	

The segment analysis is done 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 decreased moderately on the back of lower income from current accounts, which could not be fully compensated by higher fees from asset management and insurance brokerage. The decrease of net trading result and gains/losses from financial instruments at FVPL was driven by a lower contribution from foreign currency transactions. Higher personnel expenses and IT costs led to an increase in operating expenses. Deposit insurance contribution amounted to EUR 9.6 million (EUR 8.3 million). Overall, operating result increased, the cost/income ratio improved. The slightly worse impairment result from financial instruments was mostly attributable to the introduction of new parameters in the retail business. The other result deteriorated mainly due to the non-recurrence of property selling gains. The contribution to the resolution fund amounted to EUR 19.0 million (EUR 16.2 million). Altogether, these developments led to an increase in the net result attributable to the owners of the parent.

Credit risk

Credit risk exposure in the Czech Republic segment rose substantially to EUR 57.6 billion (+27.5%) on the back of the very benign economic environment and, in particular, a considerable expansion of money market business. In the Group Markets segment, risk positions more than quadrupled to EUR 11.2 billion. Loans to customers increased to EUR 27.5 billion (+7.8%), with growth in the retail business slightly stronger than in the business with corporates. Customer loan volume as a percentage of Erste Group's total loans to customers was slightly up at 18.0% (17.8%). 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 1.8% (2.1%), which continued the positive development of recent years. Improvements were identified in all customer segments, but most notably in commercial real estate lending. Default rates were again lowest in the public sector and in lending to private households. NPLs were fully covered by loan loss provisions.

SLOVAKIA

Economic review

The Slovak economy performed well in 2018. Economic growth was mainly driven by robust domestic demand. Consumption, especially household consumption, benefitted from a further improvement in the labour market, growing real wages and moderate inflation. Investments contributed significantly to the favourable economic development supported by the expansion and construction of further automotive plants. Exports, although to a lesser extent, also contributed to the economic growth and benefitted from the traditionally strong car industry. A newly built plant in Nitra started production in October 2018. The EUR 1.4 billion manufacturing facility employs 1,500 people and has an annual production capacity of 150,000 cars. Slovakia, with approximately one million cars produced in 2018, remained the world's top car producer per capita. Overall, real GDP grew by 4.1%, and GDP per capita amounted to EUR 16,500 in 2018.

Benefitting from the favourable macroeconomic developments, the fiscal position of Slovakia remained solid. Revenues were significantly supported by higher tax collection both from personal and corporate income taxes as well as from social contributions. Revenues from value-added taxes rose as well. Expenses also increased but remained well under control. Consequently, the fiscal deficit declined to 1.5%. The country's public debt as a percentage of GDP declined to 49.1%, the lowest level since 2012.

Inflation in Slovakia increased and the average consumer price index rose by 2.5% driven mainly by food, services, and energy prices. Higher services prices reflected growing disposable income of households amidst improvement in the labour market. Reflecting the upward pressure of the tightening labour market, nominal wage growth accelerated to 6.2% in 2018. Moody's kept the country's long-term credit rating at A2 with a stable outlook, while Standard & Poor's and Fitch kept their ratings at A+, also with a stable outlook.

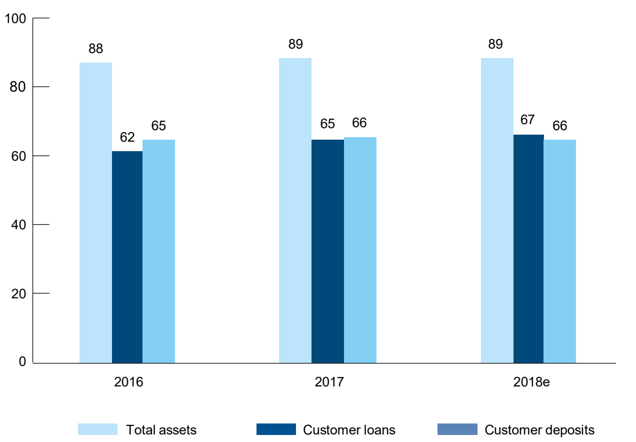
Key economic indicators – Slovakia	2015	2016	2017	2018e
Population (ave, million)	5.4	5.4	5.4	5.5
GDP (nominal, EUR billion)	79.1	81.2	84.9	90.2
GDP/capita (in EUR thousand)	14.6	14.9	15.6	16.5
Real GDP growth	4.2	3.1	3.2	4.1
Private consumption growth	2.3	2.9	3.5	3.0
Exports (share of GDP)	81.7	82.7	84.2	85.8
Imports (share of GDP)	80.4	80.7	83.4	84.9
Unemployment (Eurostat definition)	11.5	9.6	8.1	6.5
Consumer price inflation (ave)	-0.3	-0.5	1.3	2.5
Short term interest rate (3 months average)	0.0	-0.3	-0.3	-0.3
Current account balance (share of GDP)	-0.5	0.9	1.8	1.3
General government balance (share of GDP)	-1.7	-2.2	-2.0	-1.5

Source: Erste Group

Market review

The Slovak banking system benefitted again from the positive macroeconomic backdrop. Customer loans increased by 9.4%, mainly attributable to the retail sector, which grew by 11.5%. Corporate loans also increased, though to a lesser extent, and mainly driven by lending to small-and medium sized enterprises. Customer deposits rose by 7.3%, resulting in a loan-to-deposit ratio of 101.2%. 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 a number of smaller transactions throughout the year. The banking sector remained well capitalised with a capital adequacy ratio of 18.2%.

Financial intermediation – Slovakia (in % of GDP)



Source: National Bank of Slovakia, Erste Group

The Slovak banking market had another profitable year. While the low interest rate environment, banking tax and regulatory changes impacted its profitability negatively, net profit of the sector benefitted from higher fee income, positive asset quality trends and low risk costs. The NPL ratio decreased further to 3.1%. 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 7.9% at the end of the year.

Regulatory changes again played an important role in the development of the banking market. The National Bank of Slovakia introduced new measures regarding debt-to-income limits, and limited loans with a loan-to-value ratio above 80%. Newly granted loans increased visibly just before these new rules came into effect in July 2018, followed by a slowdown in the second half of the year. The national bank increased the countercyclical buffer from 0.5% to 1.25% as of August 2018.

Market shares – Slovakia (in %)

Source: National Bank of Slovakia, Erste Group

Slovenská sporiteľňa retained its leading market positions. It continued to control approximately 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 26.7%. At 13.4%, its market share in corporate deposits was significantly lower than in retail deposits, which stood at 28.0%. Slovenská sporiteľňa maintained its strong position in asset management products with a market share of above 25%.

Business review 2018 – three questions to the CEO of Slovenská sporiteľňa, Peter Krutil

How did the competitive environment change? Market conditions were favourable last year. Retail loans grew again at a double-digit pace. The Slovak National Bank has further tightened regulations of credit conditions, such as stricter debt-to-income levels. The impact on retail loan growth, however, was not substantial yet and is expected to be more visible in 2019.

The profitability of the sector improved. While robust loan growth off-set shrinking margins in retail, interest rates on corporate loans increased. Consequently, net interest income did not decline further. As a result of the persistently low interest rate environment, fee income gained in importance, in particular selling insurance products and asset management.

Considering the strategic focus of your bank, what did you do differently compared to the past? We made a visible leap in insurance intermediation, providing customers with more comprehensive solutions for their financial life and at the same time generating higher fee income.

Digitalisation has been an important topic for the bank in recent years. More and more transactions are shifted to digital channels, resulting in higher convenience for customers and lower transactions costs. Additional features for tablets used by advisors in the branches simplify the sales process and improve the customer experience.

We implemented a new approach to our brand positioning, focusing in addition to our existing customers on new and younger customer segments. At the same time, Slovenska sporitelna communicates its dedication to help make Slovakia a modern country and takes an active role in this context as a responsible leader.

In addition, we started to implement the concept of an agile way of working. We do not employ it at a large scale, but in selected high-priority areas for support in achieving quicker and better-suited client solutions.

Looking back at the year, what were the major challenges and key achievements? A major milestone was the launch of the digital platform George. We gradually rolled out new features, while at the same time managing the migration of customers from the previous internet banking. The migration to George was almost finished at year-end. Another challenge was the local launch of Erste Group's marketing concept #believeinyourself, which enjoyed high spontaneous awareness.

While defending the number one position in retail banking, we significantly improved our market share in corporate loans. This was mainly attributable to business with SMEs and large corporate customers.

Slovenská sporiteľňa ranked first in the survey conducted by the portal Profesia.sk as the best employer in banking, finance and insurance, and the bank was also recognised as the Bank of the Year 2018 by the weekly TREND, the sixth award in seven years. The outstanding position in market shares, risk parameters and sound financial results were the key factors for this result. The bank's support for society as a whole was also recognised by the Via Bona Award as the most responsible large company in the country.

Financial review

in EUR million	2017	2018	Change
Net interest income	434.3	438.7	1.0%
Net fee and commission income	112.7	128.8	14.3%
Net trading result and gains/losses from financial instruments at FVPL	13.3	11.8	-10.9%
Operating income	568.7	586.1	3.1%
Operating expenses	-281.1	-279.6	-0.6%
Operating result	287.6	306.6	6.6%
Cost/income ratio	49.4%	47.7%	
Impairment result from financial instruments	-30.1	-23.5	-21.8%
Other result	-39.5	-40.3	1.9%
Net result attributable to owners of the parent	166.2	189.4	14.0%
Return on allocated capital	24.7%	20.7%	

Net interest income in the Slovakia segment (comprising Slovenská sporitel'ňa Group) increased due to higher loan volumes. Net fee and commission income improved on the back of higher insurance brokerage as well as higher lending and payment fees. Net trading result and gains/losses from financial instruments at FVPL remained largely stable in absolute terms. Operating expenses decreased slightly despite higher personnel costs. Deposit insurance contribution amounted to EUR 0.9 million (EUR 0.8 million). Overall, operating result increased, and the cost/income ratio improved. Impairment result from financial instruments improved due to lower provisions in the retail business. Other result remained stable, as the increase of banking tax to EUR 30.3 million (EUR 27.4 million) was offset by the changed disclosure of provisions for commitments and guarantees. In 2017, this line item included a net allocation and was part of other result; from 2018, it is disclosed under impairment result from financial instruments. The payment into the resolution fund amounted to EUR 2.7 million (EUR 2.8 million). Overall, the net result attributable to the owners of the parent increased.

Credit risk

Credit risk exposure in the Slovakia segment rose to EUR 18.6 billion (+7.4%) while loans to customers increased at a faster pace to EUR 13.3 billion (+10.7%). Slovakia was thus one of the most dynamic geographical segments of Erste Group. Its share of Erste Group's total loan portfolio rose to 8.7% (8.4%). Due to strong demand for loans from the prospering industrial sector, a breakdown of the portfolio by customer segment shows a shift from retail towards corporate loans. The share of loans to private households amounted to 70.5% (72.6%) of total customer loans and was again significantly larger than in other core markets. This customer mix also explains the large share of secured business of 59.3% (58.8%) in the entire loan portfolio, which exceeds that of other Central and Eastern European core markets. The NPL ratio declined further to 3.3% (3.8%), with asset quality improving across all customer segments, but most notably among corporate customers. The NPL coverage ratio based on loan loss provisions rose to 80.9% (79.7%).

ROMANIA

Economic review

The Romanian economy expectedly cooled down from its exceptionally high growth level of 7.0% a year ago. In 2018, the country's real GDP growth equalled 4.1% GDP per capita EUR 10,400. As the effects of the fiscal stimulus of 2017 started to fade away, private consumption weakened and supported growth to a much lesser extent. The European Union funds absorption rate did not significantly improve, and investments remained subdued throughout the year. Net exports did not contribute to economic growth, despite the favourable performance of the industrial sector, including the automotive sector. The agricultural sector performed very well again. The unemployment rate declined further and reached a new historic low of 4.2%.

The political environment remained volatile. Necessary structural reforms, especially in tax collection, were not implemented. Public investments remained subdued. The government cut the flat personal income tax rate from 16% to 10% as of 1st January 2018 and shifted social security contributions from employers to employees. At 3.0%, the budget deficit increased but remained within the target of 3% of GDP. The ratio of public sector debt to GDP of 35.1% remained among the lowest in the European Union.

Inflation peaked in the spring of 2018 and slowed down in the second half of the year. As the effects of the cut in VAT and lower excise duties on fuel faded away during the year, average consumer prices increased by 4.6%. Core inflation, which excludes food and fuel prices, went up by 2.5%. Wages and pensions continued to grow. The Romanian leu was relatively stable against the euro, trading between 4.6 and 4.7 throughout the year. The Romanian National Bank increased its policy rate in three steps by 75 basis points to 2.50% in 2018.

The three major rating agencies, Standard & Poor's, Moody's, and Fitch, kept the country's long-term credit ratings unchanged and with a stable outlook throughout the year, Standard & Poor's and Fitch at BBB- and Moody's at Baa3.

Key economic indicators – Romania	2015	2016	2017	2018e
Population (ave, million)	19.9	19.7	19.6	19.5
GDP (nominal, EUR billion)	160.3	170.4	187.5	202.1
GDP/capita (in EUR thousand)	8.1	8.6	9.6	10.4
Real GDP growth	3.9	4.8	7.0	4.1
Private consumption growth	5.9	8.3	10.1	5.2
Exports (share of GDP)	34.1	33.7	33.4	33.5
Imports (share of GDP)	39.3	39.5	40.3	41.0
Unemployment (Eurostat definition)	6.8	5.9	4.9	4.2
Consumer price inflation (ave)	-0.6	-1.5	1.3	4.6
Short term interest rate (3 months average)	1.3	0.8	1.2	2.8
EUR FX rate (ave)	4.4	4.5	4.6	4.7
EUR FX rate (eop)	4.5	4.4	4.4	4.4
Current account balance (share of GDP)	-1.2	-2.1	-3.2	-4.7
General government balance (share of GDP)	-0.7	-2.9	-2.9	-3.0

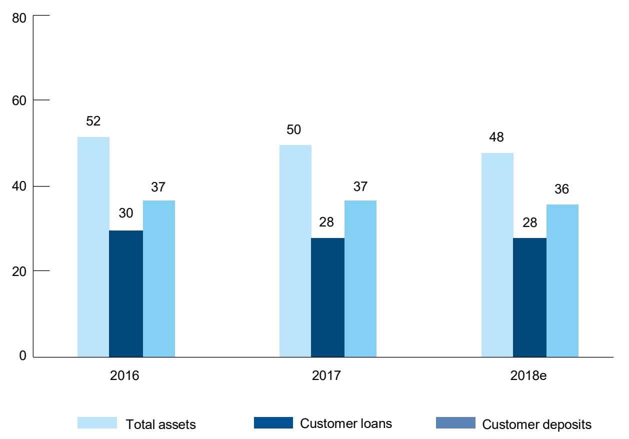
Source: Erste Group

Market review

Despite the macroeconomic slowdown, the Romanian banking market performed well. Customer loans increased by 7.5%, while customer deposits grew by 8.8%. Retail loans, significantly up by 9.2%, remained the main driver for lending, with housing loans outgrowing consumer loans. The government-guaranteed mortgage programme Prima Casa (first home) remained a key product in the market. In the corporate segment, lending grew mainly as a result of increased demand from large companies and small- and medium size enterprises, while loans to municipalities declined. The banking system's loan-to-deposit ratio dropped further to 75.9% at the end of the year.

The profitability of the country's banking market improved, mainly due to higher net interest income and lower risk provisions. The banking sector's net interest income was clearly supported by volume growth and higher interest rates. Asset quality improved further, mainly as a result of higher wages and the improved job market. Overall, the sector achieved a return on equity of 14.9%. The Romanian banking sector continued to be strongly capitalised with a total capital ratio of 19.7% at the end of the year. The National Bank of Romania decided to adopt stricter debt-to-income limits regarding mortgage and unsecured consumer loans as of January 2019. In addition, the government announced the introduction of a new asset-based banking tax starting in 2019. Consolidation of the banking sector continued, with the number of banks declining to 34 by the end of the year.

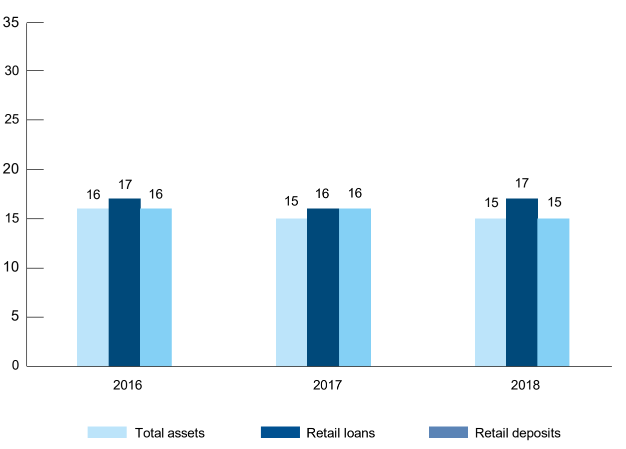
Financial intermediation – Romania (in % of GDP)



Source: National Bank of Romania, Erste Group

Banca Comercială Română lost its market leading position following the integration of Bancpost by Banca Transilvania. At year-end, Banca Comercială Română was ranked number two by total assets, customer loans, and customer deposits, but remained the largest in asset management. The bank defended its market leader position in Prima Casa, with a share of approximately 25%. The bank's customer loan market share equalled 14.0%, with the share in corporate business declining to 11.2% while the share in retail business increased to 16.7%. The customer deposit market share declined to 15.2%. In terms of total assets, Banca Comercială Română had a market share of 15.1%.

Market shares – Romania (in %)



Source: National Bank of Romania, Erste Group

Business review 2018 – three questions to the CEO of Banca Comercială Română, Sergiu Manea

How did the competitive environment change? The competitive environment in Romania featured further consolidation of the local banking market, driven by mergers and acquisitions.

Competition intensified throughout the year across all client groups, partly as non-financial industry players have entered the market. Consequently, we continue to invest to reach as many customers as possible and to further increase customer satisfaction.

Considering the strategic focus of your bank, what did you do differently compared to the past? We are driven by the clear purpose to act as a reliable financial advisor for our clients, providing loans, services and expertise to the real economy. We believe that the measure of that goal will be the level of trust we as a bank and our employees get credit for. We are on a good path: Banca Comercială Română has revamped brand strength, ranking top two in trust, responsibility and innovation.

In the strategic execution of that purpose, we focus on products, services and initiatives based on client feedback and on our commitment to learn and adapt. That also helped us narrow our strategy around seven top priorities that we either have already delivered upon or are in the process of achieving. These efforts entailed several key achievements, in particular efficiency, digitisation and accessibility. The evolution of the bank is technology driven, and this is just the beginning. We adapt relationships with our customers to the digital universe, resulting last year in a very encouraging increase of over 30% in the number of active digital clients. The innovative George platform was launched towards the end of last year, enrolling more than 100,000 users within the first month.

In addition, we have continued to optimise our processes to better serve our customers and improve the customer experience. That will be a relentless focus in the future, with the aim to focus our interaction with clients on first in class advice and seamless experience.

Looking back at the year, what were the major challenges and key achievements? In retail, one in five mortgages in Romania has been generated and one in six consumer loans has been serviced by us. On the corporate front, we continued to finance several key sectors such as manufacturing (mainly automotive), energy, agriculture and IT. The main growth driver was the SME segment.

That is why, despite the extremely competitive market environment, in 2018 we achieved a double-digit growth in our top-line revenues. We significantly increased our market penetration and defended our leading position in the retail lending market.

I am also very proud to point out that we have continued our Money School financial education programme, reaching more than 110,000 people in 2018. Our dedication to the programme has also been reflected and internationally acknowledged by setting a new Guinness World Record for the largest financial education lesson taught simultaneously.

Financial review

in EUR million	2017	2018	Change
Net interest income	365.5	394.5	7.9%
Net fee and commission income	153.4	151.9	-1.0%
Net trading result and gains/losses from financial instruments at FVPL	77.6	96.0	23.7%
Operating income	611.5	660.6	8.0%
Operating expenses	-338.0	-354.6	4.9%
Operating result	273.5	306.0	11.9%
Cost/income ratio	55.3%	53.7%	
Impairment result from financial instruments	-7.1	-26.0	>100.0%
Other result	-88.9	-18.4	-79.3%
Net result attributable to owners of the parent	120.7	219.9	82.2%
Return on allocated capital	12.5%	17.4%	

The segment analysis is done on a constant currency basis. The RON depreciated by 1.9% against the EUR in the reporting period. Net interest income in the Romania segment (comprising Banca Comercială Română Group) increased mainly on the back of sharply increased short-term market interest rates, despite being negatively impacted by a change in the segmental capital benefit calculation methodology. Net fee and commission income rose slightly in local currency terms. Net trading result and gains/losses from financial instruments at FVPL increased predominantly due to strong result from business with financial institutions, revaluation of FX participations and a better result from FX transactions in the retail business. Operating expenses increased due to higher costs related to the move to new headquarters and project costs as well as higher personnel costs. Deposit insurance contributions doubled to EUR 4.4 million (EUR 2.2 million). Overall, operating result increased, and the cost/income ratio improved. Other result improved on the release of provisions for litigations and changed disclosure of provisions for commitments and guarantees given. The resolution fund contribution declined significantly to EUR 5.5 million (EUR 14.2 million). Consequently, the net result attributable to the owners of the parent increased.

Credit risk

After several years of largely stagnating growth, credit risk exposure in the Romania segment rose to EUR 15.5 billion (+10%) in the reporting period. A key contribution to growth came from loans to customers, which increased by EUR 0.5 billion to EUR 8.3 billion. This represented an unchanged share of 5.4% of Erste Group's total loans to customers. Growth of the loan portfolio was driven by strong momentum in the retail business while the volume of business with corporates was largely unchanged. In this segment, brisk loan growth was offset by repayments and further write-downs and sales of non-performing loans. The share of foreign-currency loans decreased to 41.4% (45.8%) and was almost completely denominated in euro. Due to the ongoing clean-up of the portfolio and a comparatively low inflow of new non-performing loans, the NPL ratio declined further to 5.8% (8.1%), 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. NPLs were fully covered by loan loss provisions.

HUNGARY

Economic review

The Hungarian economy performed strongly in 2018. The main drivers of growth remained household consumption, benefitting from higher consumer confidence, increasing real wages, and continued positive trends in the labour market. Investments soared in 2018, supported mainly by construction and infrastructure related projects. The car industry remained significant, and one of the leading European car producers announced plans to invest EUR 1 billion in a new plant in Debrecen with an annual production capacity of 150,000 cars. Construction and services also performed well. In addition, the performance of agriculture improved significantly year-on-year. The trade deficit shrank versus 2017. As a result of the improved labour market, the unemployment rate fell to the historically low level of 2.8%, the third lowest in the European Union. Overall, real GDP grew by 4.8%, and GDP per capita increased to EUR 13,500.

The fiscal position of Hungary remained solid. The general government balance remained well within the Maastricht limits. The minimum wage was increased again, while government's spending on investments was substantial in 2018. These measures were to a large extent compensated by higher revenues from a larger tax base and relatively low interest payments. Overall, the budget deficit stood at 2.0%. Public debt as a percentage of GDP decreased further to 70.9%.

Inflation increased further but remained within the national bank's target range of 2% to 4%. This development was mainly driven by higher oil prices and the depreciation of the forint. Real wage growth remained high. Overall, average consumer prices increased by 2.8%. The Hungarian forint was relatively weak against the euro, trading between 310 and 330 throughout the year. The National Bank continued its expansionary monetary policy and kept the base rate at a record low of 0.90%. The interbank interest rates (BUBOR) stayed well below the level of policy rate during the year.

The three major rating agencies kept the country's long-term credit rating unchanged and with a stable outlook, Standard & Poor's and Fitch at BBB and Moody's at Baa3.

Key economic indicators – Hungary	2015	2016	2017	2018e
Population (ave, million)	9.9	9.8	9.8	9.8
GDP (nominal, EUR billion)	110.9	113.9	124.0	131.9
GDP/capita (in EUR thousand)	11.3	11.6	12.7	13.5
Real GDP growth	3.5	2.3	4.1	4.8
Private consumption growth	3.7	3.4	4.1	4.6
Exports (share of GDP)	70.7	70.3	69.0	68.3
Imports (share of GDP)	67.1	66.3	67.4	68.9
Unemployment (Eurostat definition)	6.8	5.1	4.2	3.7
Consumer price inflation (ave)	-0.1	0.4	2.4	2.8
Short term interest rate (3 months average)	1.6	1.0	0.1	0.1
EUR FX rate (ave)	309.9	311.5	309.2	318.9
EUR FX rate (eop)	313.1	311.0	310.1	321.5
Current account balance (share of GDP)	2.8	6.2	3.2	1.2
General government balance (share of GDP)	-1.9	-1.6	-2.2	-2.0

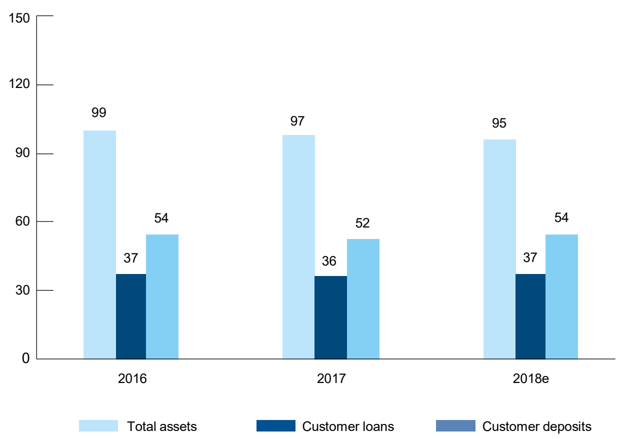
Source: Erste Group

Market review

Hungary's banking market continued to perform well, reflecting the favourable macroeconomic environment. Customer loan growth accelerated to 10.6%. Growth in the retail sector was mainly driven by the increase in mortgage lending, which was largely attributable to the Home Purchase Subsidy Scheme for families and certified consumer-friendly mortgage products. The latter was modified in 2018, as the National Bank of Hungary introduced a new fifteen-year fixed interest rate facility and terminated the three-year fixation. In addition, the National Bank also modified the payment-to-income limits with the aim of encouraging clients towards loans with longer interest rate fixation periods. In corporate lending, a new funding for growth scheme was introduced with the aim of raising the proportion of fixed-rate lending to SMEs. Overall, corporate loans increased by 14.9%, mainly driven by lending to SMEs. At 14.3%, customer deposits outgrew customer loans. Similar to the lending business, corporate deposits grew more visibly than retail deposits. The banking system's loan-to-deposit ratio stood at 67.6% at year-end.

The Hungarian banking sector increased profitability. While the low interest rate environment continued to weigh on revenues, risk provisions declined substantially on the back of net provision releases and favourable macroeconomic indicators. Banks continued to pay banking tax. It was calculated on the basis of total assets of 2016, with a tax rate of 21 basis points. The government decided to reduce the tax rate to 20 basis points from 2019 onwards. Overall, the banking sector's return on equity rose to 13.4%. The Hungarian banking sector continued to be well capitalised with a capital adequacy ratio of more than 16.8%.

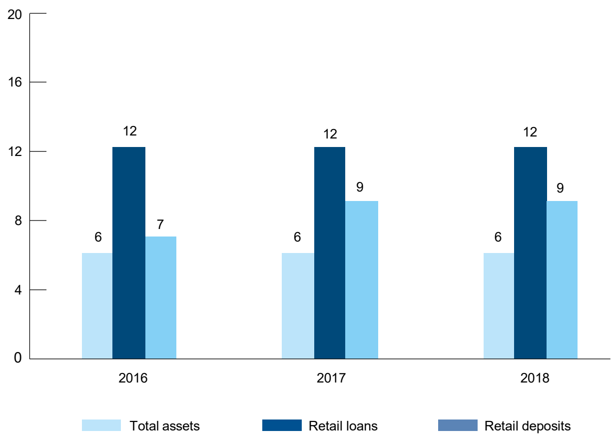
Financial intermediation – Hungary (in % of GDP)



Source: National Bank of Hungary, Erste Group

Erste Bank Hungary continued to be a major market player in the country. The bank's market share in customer loans was stable at 9.3%, with the retail business remaining at a higher share than the corporate business. Customer deposit market share edged down slightly to 7.4%. In terms of total assets, Erste Bank Hungary's market share increased to 6.1%.

Market shares – Hungary (in %)



Source: National Bank of Hungary, Erste Group

Business review 2018 – three questions to the CEO of Erste Bank Hungary, Radován Jelasity

How did the competitive environment change? After years of stagnation and even deleveraging, the Hungarian banking sector was characterised by a double-digit lending growth in 2018. Central bank initiatives influenced business development. The central bank introduced new payment-to-income limits. As a result, customers opted for long-term – at least 10 year – fixations over floating or short-term fixations. Pushing towards fixed loans started in the SME segment as well. The programme *Funding for Growth Scheme Fix (FGS Fix)* was introduced by the central bank; its objective is to raise the proportion of long-term fixed rate lending to SMEs.

Considering the strategic focus of your bank, what did you do differently compared to the past? Our focus remained on unsecured lending (consumer loans and credit cards) in retail and on SME lending in the corporate segment. We introduced products for SMEs and micro enterprises under the new brand Erste Power Business. Corporate customers have benefited from our new express loan process, retail customers from automated decision-making for unsecured loans and online personal loan application and disbursement process. In addition, we strengthened our position in the cards business. In asset management, we maintained the second position on the market.

We strive for increasing our mortgage stock further, becoming the leading market player in affluent wealth management and reaching the status as prime relationship bank with local champions in the Large Corporate segment.

Looking back at the year, what were the major challenges and key achievements? New loan disbursement increased well above market average, both in retail and in corporate business. In retail, personal loans and micro new lending doubled, and our wealth management division grew by 15%. Lending in the corporate segment grew as well substantially. New loan volumes reached the HUF 600 billion three-year strategic target half a year earlier than planned.

Among the major challenges were the labour market situation and the pace of digitalisation. Labour shortage is a barrier to growth, and the resulting wage pressure weighs on operating expenses.

We have initiated the programme *Erste Care* to recognise the loyalty of our employees. This programme comprises various elements including additional sabbatical days, health and pension insurance for our employees. Last but not least, we started the reconstruction of our headquarters to create a modern workplace.

Erste Bank Hungary has again received several awards. The bank's private banking team won *Blochamps' Business Developer of the Year* award, and among other prizes, our bank received the *ACI's Innovation Award* for a real-time electronic payment and banking solution.

Financial review

in EUR million	2017	2018	Change
Net interest income	198.4	198.8	0.2%
Net fee and commission income	157.4	170.2	8.1%
Net trading result and gains/losses from financial instruments at FVPL	35.1	45.4	29.4%
Operating income	395.0	418.4	5.9%
Operating expenses	-220.8	-212.4	-3.8%
Operating result	174.2	206.0	18.2%
Cost/income ratio	55.9%	50.8%	
Impairment result from financial instruments	35.1	36.3	3.3%
Other result	-28.6	-67.2	>100.0%
Net result attributable to owners of the parent	164.9	166.8	1.1%
Return on allocated capital	29.3%	20.8%	

The segment analysis is done on a constant currency basis. The HUF depreciated by 3.2% against the EUR in the reporting period. Net interest income in the Hungary segment (comprising Erste Bank Hungary Group) remained stable on the back of higher loan and deposit volumes, although a change in the segmental capital benefit calculation methodology had a negative effect. Net fee and commission income rose due to higher card, payments and securities fees. Net trading result and gains/losses from financial instruments at FVPL improved mainly due to the higher contribution from derivatives. Operating expenses decreased on the back of lower personnel and consultancy expenses. Deposit insurance contributions amounted to EUR 7.5 million (EUR 8.7 million). Consequently, operating result and the cost/income ratio improved. Marginally higher net releases of risk provisions (reflected in the impairment result from financial instruments) were posted in corporate business. Other result deteriorated due to the non-recurrence of provision releases and higher banking levies of EUR 58.9 million (EUR 55.3 million). This line item also included the contribution to the resolution fund of EUR 2.6 million (EUR 1.9 million). Overall, the net result attributable to the owners of the parent increased.

Credit risk

Credit risk exposure in the Hungary segment rose again significantly to EUR 8.9 billion (+13.1%). Loans to customers likewise registered robust growth, rising to EUR 4.1 billion (+9.1%). The share of the Hungary segment in Erste Group's total loans to customers was largely stable at 2.7% (2.6%). While loans to private households rose at a relatively modest rate, loans to corporates increased significantly to more than EUR 1.8 billion (+18.1%). The share of loans denominated in Hungarian forint stood at 74.5% (75.7%). Asset quality again improved substantially. Non-performing loans as a percentage of total loans to customers declined to 3.7% (5.5%). Asset quality was particularly strong in the corporate business, with an NPL ratio of 0.7% (1.7%). NPL coverage based on loan loss provisions stood at 84.6% (89.3%).

CROATIA

Economic review

The Croatian economy performed well again in 2018. Domestic demand remained the main growth driver. Private consumption benefitted from the improving labour market and increasing disposable income. Investments were supported by EU fund absorption. In addition, Croatia's well-developed tourism industry had another excellent year, with overnight stays expanding by 4%. Net exports did not contribute to GDP growth. The restructuring of Agrokor continued and a debt settlement was reached in July 2018. The negative spill-over effects on the economy were largely mitigated. The unemployment rate declined to 8.6%, still high compared to other countries in CEE. Overall, real GDP grew by 2.8% and GDP per capita increased to EUR 12,000.

Croatia recorded its first ever budget surplus in 2017, and public finances remained in good shape throughout 2018. Revenues grew strongly on the back of positive labour market developments, higher wages, and consumer spending. Expenses grew less than revenues and were driven by higher public sector salaries, which were partially offset by declining debt service costs. The general government balance stood at 0.2%, and public debt as a percentage of GDP declined to 74.1%.

Inflation remained well under control. Average consumer prices rose to a moderate 1.5% on the back of higher energy and food prices. The Croatian kuna remained broadly stable against the euro at around 7.4 throughout the year. 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, and it maintained its accommodative monetary stance throughout 2018.

The favourable economic development was recognised by Fitch and Standard & Poor's. Both rating agencies upgraded the country's long-term credit rating to BB+ with a positive outlook. Moody's kept its rating unchanged at Ba2 with stable outlook. In March 2019, Standard & Poor's further upgraded the rating to BBB- with a stable outlook.

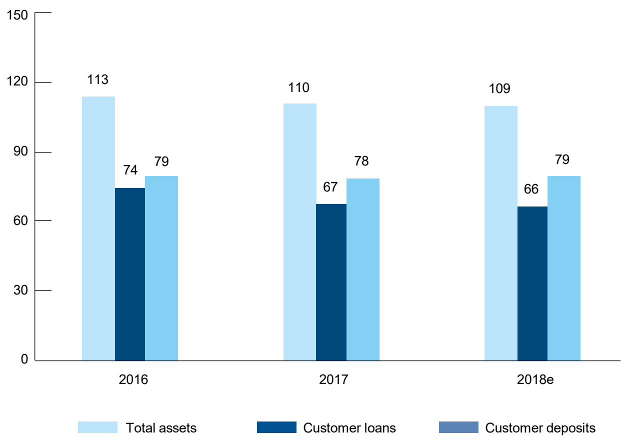
Key economic indicators – Croatia	2015	2016	2017	2018e
Population (ave, million)	4.3	4.3	4.3	4.3
GDP (nominal, EUR billion)	44.6	46.7	49.0	51.5
GDP/capita (in EUR thousand)	10.4	10.8	11.4	12.0
Real GDP growth	2.4	3.5	2.9	2.8
Private consumption growth	1.0	3.4	3.6	3.5
Exports (share of GDP)	22.8	22.5	23.9	23.4
Imports (share of GDP)	38.5	38.3	40.7	41.3
Unemployment (Eurostat definition)	16.3	13.1	11.3	8.6
Consumer price inflation (ave)	-0.5	-1.1	1.1	1.5
Short term interest rate (3 months average)	1.0	0.6	0.5	0.5
EUR FX rate (ave)	7.6	7.5	7.5	7.4
EUR FX rate (eop)	7.6	7.6	7.5	7.4
Current account balance (share of GDP)	4.5	2.6	4.0	2.3
General government balance (share of GDP)	-3.3	-0.9	0.8	0.2

Source: Erste Group

Market review

Supported by the strong economic performance, Croatia's banking market revived in 2018. After having suffered from relatively weak demand for banking products for years, the lending market recovered, and customer loans grew by 2.4%. Demand for local currency based lending remained strong. Retail lending outperformed corporate lending. Within corporate business, tourism and export-related lending increased visibly. Customer deposits increased by 5.7%, mainly driven by corporate deposits. The banking system's loan-to-deposit ratio declined to 83.3% at the end of the year. With total banking assets at 109.1% of GDP, Croatia's level of financial intermediation as well as the capital adequacy of the Croatian banking system at 22.9% remained among the highest in the region.

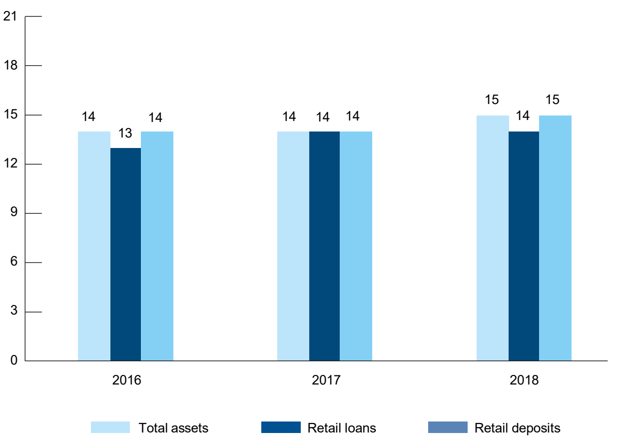
Financial intermediation – Croatia (in % of GDP)



Source: National Bank of Croatia, Erste Group

Consolidation of the banking sector continued. In terms of total assets, the merger of OTP and Splitska Banka created the fourth-largest bank of the country. Profitability of the banking sector improved visibly, supported by revived lending and lower risks costs. The market was characterised by a shift towards products denominated in local currency.

Market shares – Croatia (in %)



Source: National Bank of Croatia, Erste Group

The favourable economic environment and further sales of non-performing loans supported asset quality. The NPL-ratio declined to 9.8 % at the end of the year. The capital adequacy ratio in excess of 20% underpins the high robustness of the local banking system. Overall, the country's banking sector achieved a return on equity of 8.4%.

Erste Bank Croatia remained among the top-three players in the market, with a market share in terms of total assets of 14.7%. The bank outperformed the market, with customer loans and customer deposits increasing by 16.5% and 14.4%, respectively. The bank's loan-to-deposit ratio stood at 96.0%.

Business review 2018 – three questions to the CEO of Erste Bank Croatia, Christoph Schöfböck

How did the competitive environment change? The market environment in Croatia exhibited several important characteristics, such as the maintenance of positive trends on the fiscal consolidation side, a continuation of the consolidation trend in the banking sector and further announcements about Croatia joining the euro zone, particularly against a backdrop of a stronger involvement in the European integration space, long-term stability of the economy and a reduction of the currency risk. In this context, implementing true structural reforms, finding an adequate response to the emigration problem, and reinforcing legal and political stability have become even more important.

In spite of maintaining the euro zone course, demand for loans denominated in Croatian kuna continued to increase last year. As local currency sources of finance remain constrained by the traditionally strong preference of depositors' towards foreign currency savings, this poses a significant challenge to the banking system.

We also witnessed the first tangible responses of banks and card companies to the growing challenges of digitalisation. The processes of acceleration of time-to-market, more frequent changes and adaptations of existing products and comprehensive digital business transformation will continue next year at a faster pace.

Considering the strategic focus of your bank, what did you do differently compared to the past? Stable operations, loan growth in retail and corporate and responsible risk policy management confirm that we are following the right business model. Lower risk provisions were the main driver of the increase in net profit. This was partly due to the general positive portfolio trends and the lower share of non-performing loans, and partly a result of the elevated risk provisions related to the insolvency of the Agrokor conglomerate and its associate companies.

In addition to loan growth, our focus on SMEs helped us to maintain and strengthen our position as a market leader. On the retail side, consumer lending was the main driver of new loan growth, while mortgages maintained a moderate upward trend. Overall, we strive for sustainable success, and we focus on long-term relations with our customers and other stakeholders in social community.

Looking back at the year, what were the major challenges and key achievements? Improved process efficiency and adequate responses to human resources challenges, such as reacting to wage pressure and keeping talent in order to remain a top employer in the country, contributed to the successful business performance. In addition, we remained the market leader in customer satisfaction in the retail and corporate segments and posted stable capital adequacy parameters, a single-digit NPL-ratio and a balanced loan-to-deposit ratio.

We consider the development of digital channels as an important part of our long-term strategy. This made the introduction of the first fully digitalised credit card application procedure in the Croatian market possible and the launch of a mobile app featuring a special functionality to allow users to manage transactions in instalments. In addition, the bank launched another app that allows users to send and receive payments quickly, securely and free of charge. This is the first banking solution in the Croatian market designed for all users, regardless of the bank with which they have their account.

Our bank was named Most Active Partner Bank in Croatia by the EBRD *Trade Facilitation Programme;* its aim is to promote growth through trade finance activities and support exports.

Financial review

in EUR million	2017	2018	Change
Net interest income	270.5	273.7	1.2%
Net fee and commission income	95.8	98.9	3.2%
Net trading result and gains/losses from financial instruments at FVPL	26.6	30.3	13.8%
Operating income	414.0	420.3	1.5%
Operating expenses	-206.3	-212.5	3.0%
Operating result	207.7	207.8	0.0%
Cost/income ratio	49.8%	50.6%	
Impairment result from financial instruments	-116.1	-33.1	-71.5%
Other result	-9.0	-1.3	-85.2%
Net result attributable to owners of the parent	37.7	95.7	>100.0%
Return on allocated capital	10.4%	19.1%	

The segment analysis is done on a constant currency basis. The HRK appreciated by 0.6% against the EUR in the reporting period. Net interest income in the Croatia segment (comprising Erste Bank Croatia Group) increased as higher contributions from deposits and consumer loans in the retail business offset a lower contribution from balance sheet management and lower corporate lending volumes. Net fee and commission income rose as higher card and payment fees in retail and corporate business entirely compensated non-recurring income from debt issuance realised last year. Net trading result and gains/losses from financial instruments at FVPL increased on the back of higher gains from foreign-exchange transactions. Operating expenses went up due to higher personnel as well as IT costs and included a EUR 11.1 million (EUR 10.9 million) deposit insurance fund contribution. Overall, operating result remained stable, while the cost/income ratio increased. The notable improvement of impairment result from financial instruments was primarily driven by significantly lower provisioning needs in the corporate business. Other result improved on the non-recurrence of last year's impairment of a participation. This line item included resolution fund contribution in the amount of EUR 3.8 million (EUR 4.0 million). Consequently, the net result attributable to the owners of the parent improved significantly.

Credit risk

In the Croatia segment, credit risk exposure rose to almost EUR 9.9 billion (+5.5%), while loans to customers increased slightly faster to EUR 6.7 billion (+5.8%). The share of this segment in Erste Group's total loans to customers was unchanged at 4.4%. The composition of the loan portfolio by customer segment shifted slightly from corporate to retail loans. At 9.4% (9.5%), the public sector accounted for a significantly larger share in the Croatia portfolio than it did in the group as a whole. The share of local currency loans rose to 35.8% (31.5%) of total loans to customers. Most loans were still denominated in euro. The volume of Swiss franc denominated loans was down to 0.4% (1.0%). Due to the widespread use of the euro in Croatia, the share of foreign-currency loans is still high but has been declining continuously in recent years. Euro loans are usually matched by corresponding income or deposits in euro. Asset quality, which in the previous year had been impaired by the default of one large corporate, improved again significantly. The NPL ratio decreased to 9.5% (12.3%). The NPL coverage ratio based on loan loss provisions rose to 73.5% (70.9%).

SERBIA

Economic review

The Serbian economy continued its very good performance in 2018. Economic growth was driven by robust private and public consumption and double-digit investment growth. Consumption benefitted from growing wages, increasing consumer confidence and further improvements in the labour market. In addition, construction activity grew significantly, and the agricultural sector also performed well. Despite the vibrant performance of exports, the trade balance did not contribute to economic growth due to strong import demand. The unemployment rate declined further to 13.3%, still high compared to other CEE markets. Overall, real GDP grew by 4.3%, and GDP per capita stood at EUR 6,100.

Fiscal consolidation in Serbia improved further, and the general government balance again recorded a surplus. The positive development of the fiscal position was a result of robust consumption, more efficient tax collection and an improved labour market. Public debt as a percentage of GDP improved to 53.8%. Inflation decreased and remained within the national bank's target range of 1.5% to 4.5%. Overall, average consumer prices increased by 2.0%. The Serbian dinar remained broadly stable versus the euro throughout the year. The stable currency and improved fiscal performance led the National Bank of Serbia to cut the base rate by 50 basis points to 3.00%. Standard & Poor's upgraded the country's outlook from stable to positive and assessed the country's long-term credit rating at BB. Fitch kept the rating at BB and Moody's at Ba3, both with a stable outlook.

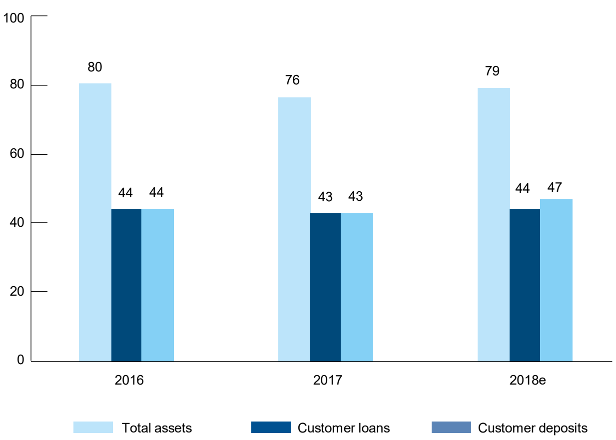
Key economic indicators – Serbia	2015	2016	2017	2018e
Population (ave, million)	7.1	7.1	7.0	7.0
GDP (nominal, EUR billion)	35.7	36.7	39.2	42.8
GDP/capita (in EUR thousand)	5.0	5.2	5.6	6.1
Real GDP growth	1.8	3.3	2.0	4.3
Private consumption growth	-1.1	1.4	2.1	3.3
Exports (share of GDP)	33.7	36.6	38.4	38.0
Imports (share of GDP)	45.0	46.5	49.5	51.2
Unemployment (Eurostat definition)	18.2	15.9	14.1	13.3
Consumer price inflation (ave)	1.4	1.1	3.1	2.0
Short term interest rate (3 months average)	6.1	3.4	3.4	2.9
EUR FX rate (ave)	120.7	123.1	121.3	118.3
EUR FX rate (eop)	121.5	123.4	118.2	118.3
Current account balance (share of GDP)	-3.4	-2.9	-5.2	-5.2
General government balance (share of GDP)	-3.5	-1.2	1.1	0.6

Source: Erste Group

Market review

The positive macroeconomic performance was also reflected in the performance of the Serbian banking market. The lending market, similar to the previous year, was largely driven by retail loans, which increased by 12.5%. Corporate loans started to recover and grew by 7.6%. Customer deposits increased by 15.2%, mainly attributable to the retail business. At year-end, the banking sector's loan-to-deposit ratio stood at 94.4%. Consolidation of the sector continued. Many of the country's largest banks were owned by foreign parent companies, among which Italian, French, Austrian and Hungarian banks controlled 58% of total assets. Serbia's banking sector remained well capitalised, with the total capital ratio of above 20%.

Financial intermediation – Serbia (in % of GDP)



Source: National Bank of Serbia, Erste Group

The Serbian banking sector posted another highly profitable year. Operating result of the banking sector improved further on higher net interest income and fee and commission income as well as strict cost control. Profitability was also supported by releases in risk provisions. Asset quality improved mainly on the back of the low interest rate environment and favourable labour market development. The NPL ratio in the retail business continued to be significantly lower than in the corporate segment. Overall, the sector's return on equity stood at 11.3%.

Erste Bank Serbia maintained its position among the country's top ten banks and continued to gain market share in both retail and corporate business. Its market share of customer loans increased to 6.3%, retail and corporate market shares stood at 6.5% and 6.1%, respectively. The bank's market share for customer deposits stood at 4.9%. The bank's deposit base remained evenly divided between euro and dinar deposits. Erste Bank Serbia's loan-to-deposit-ratio equalled 121.5%.

Business review 2018 – three questions to the CEO of Erste Bank Serbia, Slavko Carić

How did the competitive environment change? The consolidation wave that started a year ago continued, creating two stronger players. OTP acquired Vojvođanska Banka, pushing total combined assets of OTP's Serbian subsidiary up two and a half times its initial size, and Direktna Banka roughly doubling in size after having acquired Piraeus Bank's Serbian subsidiary, thus creating a strong mid-size player.

Most of the banks have retained their focus on retail business, which was the main growth driver of lending activity. The leading retail banks continued to focus on mortgages and cash loans. The corporate sector has started to recover, particularly in the SME business.

Considering the strategic focus of your bank, what did you do differently compared to the past? In 2018, we continued to focus on mortgages. High levels of customer satisfaction combined with favourable conditions based on customer needs resulted in 40% year-on-year growth. We are proud of our customer experience results; 85% of the respondents are satisfied or even completely satisfied with the process of granting mortgages. Our net promoter score in the semi-annual survey confirmed a very high result.

We continued to expand our footprint and opened five new branches. The total branch network comprises 87 branches as of year-end.

We have started a transformation process and aim at becoming the top bank in terms of customer experience, being among the top 3 in terms of profitability, and we want to be the employer of choice in our market.

Looking back at the year, what were the major challenges and key achievements? 2018 was characterised by stricter regulatory requirements, and we had to cope with a huge IT migration project. Despite these headwinds, we were particularly successful in the retail area. We achieved retail lending growth of 34%, while the market grew 13%. Growth in the corporate area was not as pronounced, but at 22%, also exceptional. In addition to lending growth in the corporate business, the development in fee income was highly satisfactorily, mainly driven by cash management. The robust performance in lending growth was made possible by our excellent service quality and the expansion of our branch network. Even with lending growth, we kept asset quality at very healthy levels. At year-end, the NPL-ratio stood at 1.7%.

Another highlight of the year was the new marketing campaign focusing on the topic of brain drain in Serbia, winning the *Silver Effie Award 2018* in the Financial Services category for the Housing Loan 2017 campaign. *Effie Worldwide* are globally recognised awards for the efficiency and effectiveness of brand communication, and the precondition are measurable results showing brand achievements of the campaign compared to previously given targets.

Financial review

in EUR million	2017	2018	Change
Net interest income	51.3	50.7	-1.1%
Net fee and commission income	11.3	13.4	18.4%
Net trading result and gains/losses from financial instruments at FVPL	4.1	5.1	23.6%
Operating income	67.0	69.3	3.4%
Operating expenses	-45.1	-49.6	10.1%
Operating result	21.9	19.7	-10.3%
Cost/income ratio	67.3%	71.6%	
Impairment result from financial instruments	1.2	1.7	40.6%
Other result	-0.3	-0.5	60.9%
Net result attributable to owners of the parent	17.0	15.5	-8.9%
Return on allocated capital	15.5%	10.1%	

The segment analysis is done on a constant currency basis. The RSD appreciated by 2.6% against the EUR in the reporting period. Net interest income in the Serbia segment (comprising Erste Bank Serbia Group) decreased due to a lower contribution from the corporate business and balance sheet management despite better performance of the retail business on higher loan and deposit volumes. Net fee and commission income improved due to higher guarantee fees in corporate business and higher payment fees in retail business. Net trading result and gains/losses from financial instruments at FVPL went up on the back of government bond valuation effects. The increase in operating expenses was driven by higher personnel and IT costs. Deposit insurance contribution rose to EUR 4.0 million (EUR 3.2 million). Operating result thus declined, and the cost/income ratio deteriorated. The slight improvement of impairment result from financial instruments was primarily driven by model changes. Overall, the net result attributable to the owners of the parent decreased.

Credit risk

Credit risk exposure in the Serbia segment increased substantially to nearly EUR 1.9 billion (+24.5%). The customer loan portfolio also registered strong growth. Loans to customers increased to almost EUR 1.3 billion (+30.7%). This very dynamic development was attributable in almost equal parts to the expansion of retail and corporate businesses, while lending to the public sector declined slightly. The share of foreign-currency loans – denominated almost exclusively in euro – in the total loan portfolio stood at 77.8% (78.0%). This very large share of foreign-currency loans is mainly attributable to the wide-spread use of the euro in Serbia due to the weakness of the local currency. Euro loans are usually matched by corresponding income or deposits in euro. Write-downs, partly in connection with the adoption of IFRS 9, and sales of non-performing loans resulted in another visible improvement in asset quality. Non-performing loans as a percentage of the total loan portfolio declined to 1.7% (3.3%). NPLs were fully covered by loan loss provisions.

OTHER

Financial review

in EUR million	2017	2018	Change
Net interest income	105.5	113.7	7.8%
Net fee and commission income	-30.0	-58.4	94.8%
Net trading result and gains/losses from financial instruments at FVPL	-140.2	-44.7	-68.1%
Operating income	-35.2	25.8	n/a
Operating expenses	-269.6	-236.3	-12.4%
Operating result	-304.8	-210.5	-30.9%
Cost/income ratio	>100.0%	>100.0%	
Impairment result from financial instruments	-12.6	-6.6	-47.5%
Other result	-37.5	-103.4	>100.0%
Net result attributable to owners of the parent	-256.8	-121.6	-52.7%
Return on allocated capital	-3.0%	-1.9%	

Operating income improved primarily due to a better valuation result in the line item gains/losses from financial instruments at FVPL. Operating expenses declined despite higher IT costs, and operating result improved. Other result deteriorated on the non-recurrence of last year's selling gains. Overall, the net result attributable to the owners of the parent improved.