

Erste Bank Hungary Rt. Annual Report 2002





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INTRODUCTION

Letter to customers, business partners and shareholders

Dear Customers, Partners, Shareholders,

2002 was the most successful year ever in the history of ERSTE BANK HUNGARY RT. Our market position strengthened to an extraordinary extent, the range of our services and products expanded considerably, and the brand Erste Bank is among the top in the list of popularity of Hungarian banks.

INCREASINGLY SIGNIFICANT MARKET PRESENCE

The 2002 financial data of Erste Bank speak for themselves. With constantly improving profitability ratios, the market share of our bank has been constantly growing in every market segment. The Erste Bank Hungary Group produced an overall growth of 47.5%, which is more than double the average growth rate in the Hungarian banking sector. Combined profits amounted to seven times that in the preceding year and, by balance sheet total, Erste Bank advanced to eighth place in the ranking of Hungarian banks. The market performance of our subsidiaries merit particular attention. Of them, Erste Befektetési Rt. has been outstanding: throughout last year, the brokerage firm held a leading position and completed the year in the first place in securities trading among brokerage firms.

STRATEGIC STEPS

Erste Bank assigns the main priority to its retail and small and medium-sized customers. To improve the quality of the services provided to them, we attach particular importance to increasing the branch network: under the Retail Network Development Project, the number of network units expanded by thirteen new branches, thus, by the end of the year, there were 79 Erste Bank branches open to our customers throughout the country.

In addition, we have been refurbishing our branches so as to be able to serve our customers in an environment that meets Erste Bank standards. The Budapest Credit Centre co-ordinating retail lending began operating in 2002 so as to develop our services.

We paid particular attention to the development of our electronic banking services. Erste Bank's ATM network was considerably enlarged, and the services at the Erste Bank Call Centre were also enhanced and improved. This latter greatly contributed to improving the efficiency of administration and the security of payment transactions.

One of the most important objectives of Erste Bank Group is to develop its universal banking services. The acquisition of a 91 per cent holding in Erste Befektetési Rt. also supports the achievement of this objective. With this, Erste Bank became the exclusive owner of the brokerage firm, which development facilitates the administration of securities trading operations in every branch. Another important step was the acquisition of Erste S Leasing Rt., a company providing financial leasing services.

MARKET AMBITIONS AND PLANS

The strategic objective of ERSTE BANK HUNGARY RT. is to become a leading bank in Hungary by reaching a market share of 20-25% in the retail and the SME market within 3-5 years. We intend to achieve the objective set by focused regional and customer segmentation, a vigorous increase in the number of customers, acquisitions, the ongoing development of the products offered, increasing the deposit and credit portfolios and building up new distribution channels.

We are grateful to our customers, partners and shareholders for their confidence in us being able to implement these plans

and for honouring our efforts by making use of Erste Bank services in an increasingly wide range. We trust we will be able to further expand this co-operation in the future and Erste Bank will thus be enabled to be one of the first to anticipate the demands of its domestic banking customers.



Reinhard Ortner

Chairman of the Board of Directors of ERSTE BANK HUNGARY RT.
Member of the Presidium of Erste Bank der oesterreichischen Sparkassen AG

MAIN FINANCIAL DATA

	2000 (Ft million)	2001 (Ft million)	2002 (Ft million)
Balance sheet total	199,847	272,323	392,335
Capital adequacy ratio	10.29%	11.51%	8.07 %
Pre-tax profit	382	114	1,040
Balance sheet profit figure	311	103	783

According to the Hungarian Accounting Standards, non-consolidated data

STRATEGIC OBJECTIVES

The Report of the Board of Directors

2002 was the most successful year in the history of ERSTE BANK HUNGARY RT. With vigorous growth in customer portfolios, we have been increasing and expanding our market shares in every relevant market segment; we managed to achieve this expansion with considerably improved profitability ratios. The Bank successfully over-fulfilled its customer portfolio plans, which envisaged dynamic growth for 2002. Under the Retail Network Development Project, we expanded the number of retail network units with 13 branches presenting a uniform image in the course of the year (thus, by the end of 2002, we had as many as 79 retail branches), laying the foundations for the development of the coming years in the retail and SME market segments constituting the first priority for the Bank. In addition, we continued with the refurbishing of existing branches so as to meet the high customer-oriented Erste Bank standards. In addition to investing in our branches, we considerably expanded Erste Bank's ATM network in the year. The improvement of the services of the Bank Call Centre required a great deal of resources; the Budapest Credit Centre co-ordinating retail lending also began its operation in 2002.

We uphold our strategic objective of reaching a market share of 20-25% within 3-5 years. The acquisition of the 91 per cent holding in Erste Bank's brokerage firm, Befektetési Bank Rt., was an important step towards establishing universal banking services. The Erste Bank Hungary Group was also supplemented with a subsidiary offering financial leasing services in the course of 2002. The implementation of the Management Information System (MIS), developed and structured in accordance with the expectations of the parent bank, was another considerable achievement.

In 2002, the Bank experienced a substantial breakthrough: dynamic portfolio growth was coupled with a sudden improvement in profitability. In the course of the year, ERSTE BANK HUNGARY RT. improved its return on assets, return on equity and cost-to-income ratios on an ongoing basis. According to our calculations, this favourable tendency will also characterise the strategic plan period of 2003-2005.

Ft million	HAS* non-consolidated			IAS** non-consolidated		
	2001	2002	%	2001	2002	%
Balance sheet total	272,323	392,335	44.1%	271,704	403,841	48.63%
Annual profit	103	783	660.2%	1,135	1,627	43.35%
Customer credit portfolio	163,390	261,660	60.1%	168,119	265,697	58.04%
Customer deposit portfolio	181,301	214,675	17.4%	170,257	214,872	26.20%

* Hungarian Accounting Standards

** International Accounting Standards

ECONOMIC ENVIRONMENT IN 2002

In 2002, the growth rate of the gross domestic product did not reach the levels experienced in earlier years, attributable primarily to the downward trend in the international trade cycle. Yet the growth rate was showing signs of recovery throughout the year, as the expansion of 2.9% in the first quarter was followed by 3.1% in the second quarter, 3.4% in the third quarter and 3.7% in the fourth quarter. This slight upward trend was the result of the government's economic policy boosting domestic demand manifested, in addition to the boom in household consumption generated by a more than 10% increase in real wages, in the drastic rise in general government deficit. The substantial domestic absorption created a strong demand for imported consumer goods, while exports were ailing for several reasons: firstly, the weakening international economic environment already referred to

reduced demand for Hungarian goods; secondly, the forint continuously strengthening in the course of the year led to a deterioration in the competitiveness of exporting companies. These circumstances led to a dramatic shrinkage in investment in manufacturing industry regarded as the driving force behind exports. Here a decline of 14.8% was registered relative to the preceding year. Growing domestic absorption coupled with an export sector struggling for survival naturally led to deteriorating external equilibrium indicators: the deficit in the current account exceeded EUR3.5 billion in 2002. In comparison to 2001, annual average inflation declined considerably in 2002, as its rate was no more than 5.3% after the 9.2% measured in 2001. This was attributable primarily to the price-disciplining impact of imported products becoming cheaper owing to the strong forint.

¹ From 1 January 2003, MNB (the Hungarian central bank) calculates changes in the current account according to a new methodology. The current account deficit calculated on the basis of this new methodology was not EUR3.5 billion but EUR 2.2 billion in 2002.

Macroeconomic indicators 2000-2003

Growth relative to the same period of the preceding year (%)	2000	2001	2002 Estimate	2003 Forecast
GDP	5.2	3.8	3.3*	3.5
Household consumption	4.1	4.0	8.5	6.6
Communal consumption	2.9	0.5	4.0	3.5
Gross investment	7.7	3.1	5.6	5.7
Export	21.8	9.1	4.0	6.8
Import	21.1	6.3	8.0	7.7
Inflation	9.9	9.2	5.3*	5.1
General government deficit (as percentage of GDP)	3.5	3.1	9.6*	4.8
Current account deficit (EUR billion)	1.6	1.2	3.5*	4.0

* Fact

The economic policy environment was expected to change in 2003. The MNB was no longer be able to maintain its unrealistically high interest rate level, as the speculative attack on the forint in January forced the central bank to reduce its rates by 100 bps twice. In effect, the MNB has abandoned its inflation target for December 2003, as it now focuses on a

December value of around 5% instead of the initially set maximum of 4.5%. With this, the central bank avoided the need to shift the exchange rate band in a manner equivalent to appreciating the forint and instead opted to modify the inflation target. It currently concentrates on the sustainability of an inflation target of 3.5+/-1% for the end of 2004.