

Inside Central & Eastern Europe

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Moody's Focus on Central and Eastern Europe

This compendium brings together Moody's recent research on Central and Eastern European sovereign, banking, insurance and corporate finance credit, reflecting the region's favourable growth prospects, rising international issuance and increasing investor demand for credit ratings and research over the past few years.

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Stable 2019 outlook for CEE sovereigns balances steady growth and institutional challenges 2

The region will record strong economic growth above the European average which will support modest declines in public debt ratios. However, tightening financing conditions, trade tensions and the decelerating European economy will begin to weigh on macroeconomic indicators.

Productivity growth key for CEE income convergence with EU 4

Convergence with EU-28 income levels is at risk of slowing unless CEE sovereigns restructure their economies and start to realize higher productivity gains. Czech Republic, Poland and Bulgaria are most likely to do so given their institutional capacity to leverage their catch-up potential.

GDP growth will support banks' loan growth and asset quality 6

Growth in the CEE region will be strong at 3.7% in 2019, well above the EU average of 2.0%. Relatively low private-sector debt allows the region's banks ample room for credit expansion. However, persistently low interest rates and sizable regulatory costs will constrain earnings.

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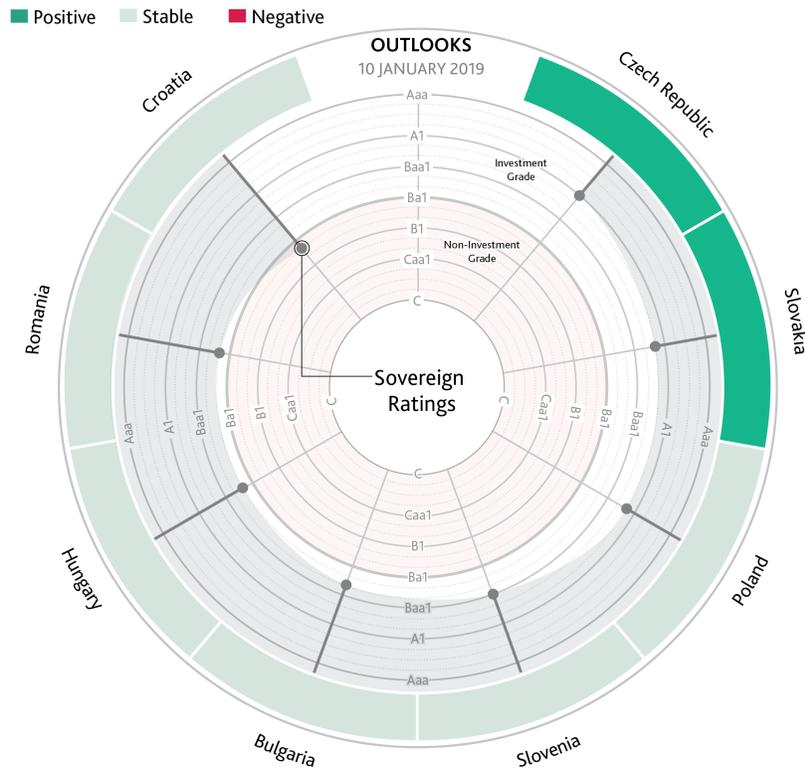
Stable 2019 outlook for CEE sovereigns balances steady growth and institutional challenges

Originally [published](#) on 10 January 2019

Our outlook for sovereign creditworthiness in 2019 in Central and Eastern Europe (CEE) is stable overall, reflecting our expectation for the fundamental conditions that will drive sovereign credit over the next 12 to 18 months. The region will record strong economic growth above the European average in 2019 which will support modest declines in public debt ratios. However, tightening financing conditions, trade tensions and the decelerating European economy will begin to weigh on macroeconomic indicators. The less benign credit environment will challenge budgetary performances and test fiscal and monetary policy responses, while increased uncertainty in the financial markets could lead to bouts of volatility. Moreover, some weakening in the rule of law and institutional independence as well as the rise of anti-establishment parties increase political risks and policy uncertainty.

Exhibit 1

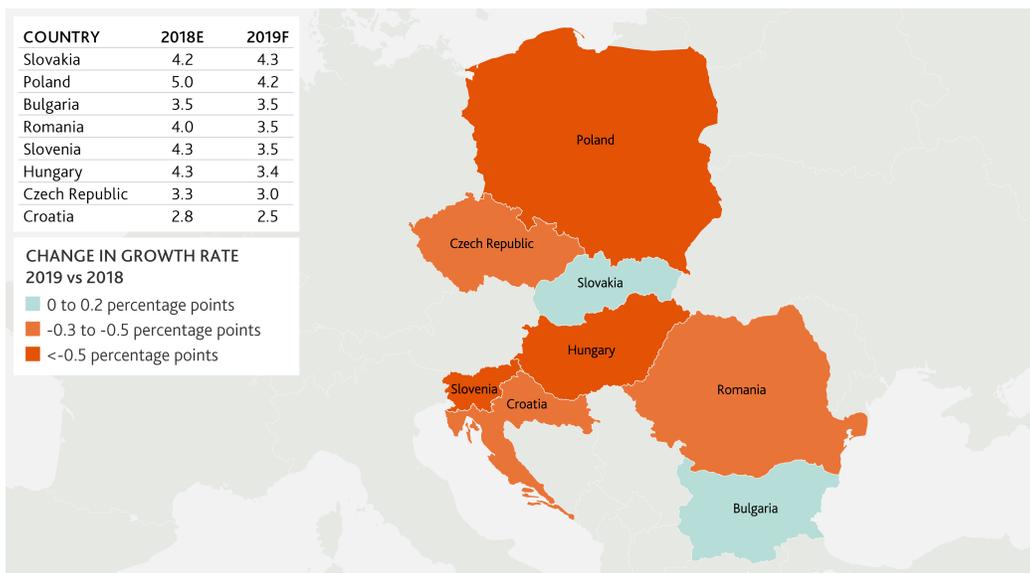
Majority of CEE sovereigns carry a stable outlook as of 10 January 2019



Source: Moody's Investors Service

Exhibit 2

Growth will slow in most CEE countries in 2019

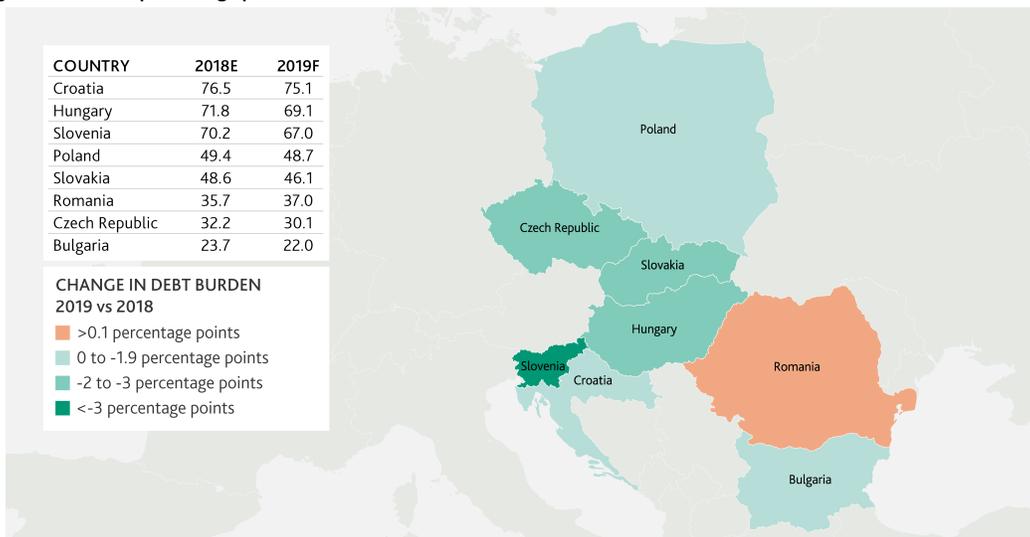


Source: Moody's Investors Service

Exhibit 3

GDP growth will support modest declines in debt burdens

Year-on-year change in debt/GDP, percentage points



Source: Moody's Investors Service

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Productivity growth key for CEE income convergence with EU

Originally *published* on 03 December 2018

Central and Eastern Europe's (CEE-8) convergence with EU-28 income levels is at risk of slowing unless they restructure their economies and start to realize higher productivity gains. Based on the potential boost to overall productivity levels from closer sector and productivity alignment with EU averages and their institutional capacity to leverage that potential, [Czech Republic \(A1 positive\)](#), [Poland \(A2 stable\)](#) and [Bulgaria \(Baa2 stable\)](#) are most likely to do so.

- » Abundant labour and EU accession drove first phase of CEE-8 catch-up since late 1990s. Low-wage, skilled labour, EU funding and integration into European value chains coupled with sizeable FDI have driven improvements in productivity. As this supported rising growth and incomes, a number of the region's sovereigns realized improvements in economic strength, which in turn contributed to rating upgrades in several cases.
- » However, their traditional growth model is running out of steam. The speed at which the CEE-8 is catching-up with EU-28 productivity levels has slowed significantly over 2009-17 compared to 2000-08.
- » Overall, the countries with the most significant catch-up potential are often also the countries that face the biggest hurdles to realize that potential due to their relatively weak institutional strength, ability to innovate and quality of human capital.
- » Bulgaria and [Romania \(Baa3 stable\)](#) show the largest catch-up potential, but their capability to leverage that potential is constrained by relatively weak profiles in terms of institutions and readiness for innovation. Among the two, Bulgaria is better positioned than Romania.
- » Some of the countries that stand out in terms of their capability to realize productivity potential – e.g. [Slovakia \(A2 positive\)](#) and [Slovenia \(Baa1 stable\)](#) – have a relatively low potential for catching-up, which will weigh on their future speed of convergence.
- » Looking at the three dimensions of the analysis – sector alignment, productivity alignment and capability to realize that potential – the countries that show a promising combination of catch-up potential and ability to leverage that potential are the Czech Republic, Poland and Bulgaria, to a lesser extent [Hungary \(Baa3 stable\)](#).
- » Continued productivity improvements are crucial for future cohesion of the EU. A slowdown or even reversal of convergence of living standards of CEE-8 with the EU could lead to declining popular support for the EU, which could further lift approval of populist parties and politicians. This would in turn add to already challenging policy making in Europe.

Exhibit 1

Combining potential and capacity shows a lead for Czech Republic, Poland and Bulgaria

Ranking of CEE-8 from 1 (strongest) to 8 (weakest)

	Catch up potential			Capabilities to leverage potential								
	Sectoral shift	Productivity	Overall	Institutional strength	European Innovation Scoreboard	Readiness for the Future of Production	Research and development expenditure (all sectors)	High-tech exports	Employment in high- and medium-high technology manufacturing sectors	Individuals who have basic or above basic overall digital skills	Tertiary educational attainment	Adult participation in learning
	Rank	Rank	Rank	Rank	Rank	Rank	Rank	Rank	Rank	Rank	Rank	Rank
Bulgaria	2	1	1	7	7	7	7	8	7	7	5	6
Romania	1	2	2	8	8	6	8	6	5	7	8	8
Poland	3	3	3	5	5	2	4	5	5	5	2	4
Hungary	7	4	4	6	3	4	3	1	3	4	6	3
Croatia	5	5	5	2	6	7	5	4	8	6	7	6
Czech Republic	8	6	6	1	2	1	2	2	1	1	4	2
Slovakia	6	7	7	2	4	3	6	3	2	2	3	5
Slovenia	4	8	8	2	1	4	1	7	3	3	1	1

Sources: Eurostat, EC, WEF, Moody's Investors Service

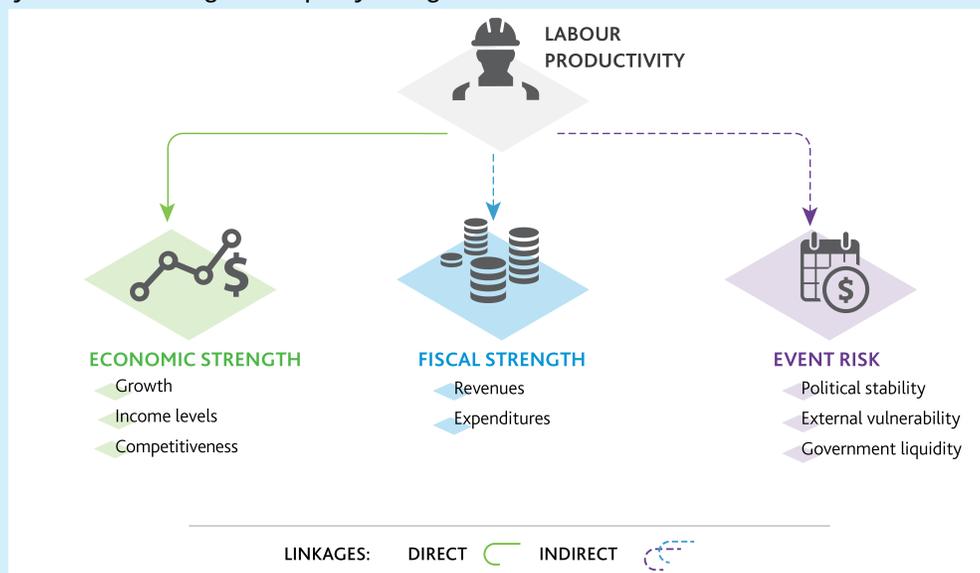
Box 1: Labour productivity and creditworthiness

Labour productivity is a key element to assessing living standards as it is directly linked to per-capita income. However, labor productivity only partially reflects the personal capacities of workers and the intensity of their effort. It depends to a large degree on the presence of other inputs, such as the joint influence of changes in capital as well as technical, organizational and efficiency change within and between firms, the influence of economies of scale, varying degrees of capacity utilisation and measurement errors.

Labour productivity can affect sovereign credit quality through various direct and indirect channels (see Exhibit 4). It is directly linked to per-capita income and a crucial determinant of trend growth, which are important indicators for our assessment of economic strength. It also indirectly impacts fiscal strength as higher economic growth supports tax collection and lowers social spending in the labour market. Moreover, labour productivity is indirectly linked to our assessment of event risk because rising living standards are an important indicator of political stability. Additionally, countries with rising productivity and competitiveness typically attract sizeable FDI and have more attractive financing conditions on the capital markets.

Exhibit 2

Labor productivity can affect sovereign credit quality through various channels



Source: Moody's Investors Service

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FEATURE ARTICLES

GDP growth will support banks' loan growth and asset quality

Originally published on 28 November 2018

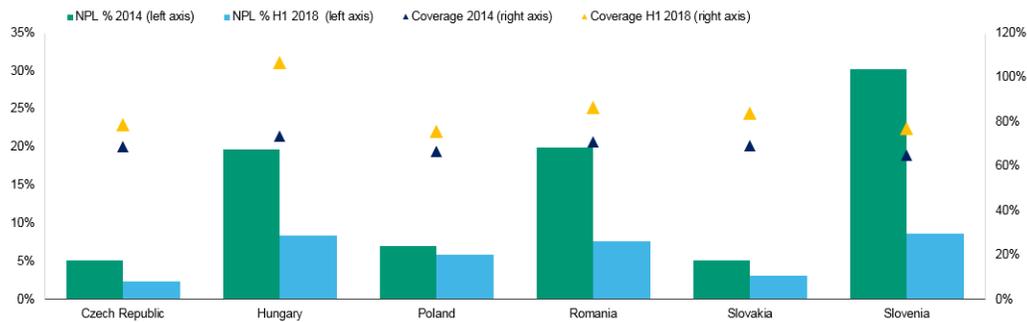
Asset quality will remain sound

- » A favourable operating environment in the CEE will keep asset risk low in the Czech Republic, Poland and Slovakia and support further, though more moderate, improvements in Hungary, Romania and Slovenia over the next 12 to 18 months.
- » Provisioning coverage for problem loans has risen across the board and will remain good for most banks.
- » Over the longer term, banks' underwriting quality in rapidly growing lending segments, such as mortgages, consumer loans and SMEs, will be tested as interest rates rise from historically low levels.

Exhibit 1

Loan quality has improved across all CEE banking sectors

Evolution of problem loans (NPLs) % gross loans and loan-loss reserves % of problem loans (provisioning coverage)



Note: Data for Romania as of Dec 2017 since H1 2018 data are not available
Source: Moody's Investors Service

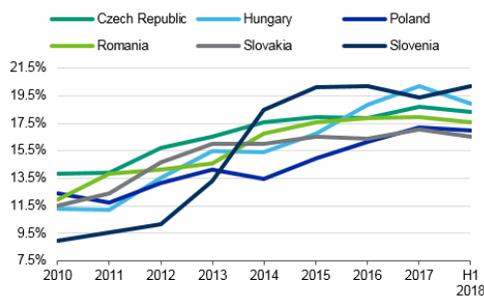
Capital will remain adequate

- » Robust lending growth and high dividend pay-outs to foreign parents will keep capital stable at best.
- » Overall, capital will remain adequate across the region.

Exhibit 2

Capital levels are adequate across the region...

Aggregate Tier 1 ratios for CEE banking systems

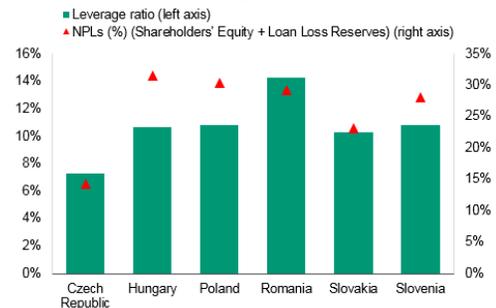


Source: Financial supervisory authority of Poland; national banks of the Czech Republic, Hungary, Slovakia, Romania and Slovenia

Exhibit 3

...and leverage ratios are high

Leverage and loss absorption capacity as of H1 2018



Note: NPL ratios are based on rated banks. Data for Romania as of Dec 2017 since H1 2018 are not available. Leverage ratios for Czech banks are affected by carry trades which increase balances they hold at the central bank.
Source: Financial supervisory authority of Poland; national banks of the Czech Republic, Hungary, Slovakia, Romania and Slovenia; Moody's Investors Service

Moody's CEE6 rated banks

Exhibit 4

Czech Republic		A1 - Positive Outlook			Government Support	Deposit Rating (Domestic) and Issuer Outlook
Bank	BCA	Adj BCA	LGF uplift			
Ceska Sporitelna, a.s.	a3	a3	2	0	A1/P-1/STA	
Ceskoslovenska Obchodni Banka, a.s.	a3	a3	2	0	A1/P-1/STA	
Komerčni Banka, a.s.	a3	a3	2	0	A1/P-1/STA	
MONETA Money Bank, a.s.	baa2	baa2	-1	1	Baa2/P-2/POS	
Raiffeisenbank, a.s.	baa3	baa3	2	0	Baa1/P-2/POS	
Czech Export Bank, a.s.	-	-	-	-	A1/P-1/STA*	
UniCredit Bank Czech Republic and Slovakia, a.s.	-	-	-	-	Covered bonds: Aa3	

Poland		A2 - Stable Outlook			Government Support	Deposit Rating (Domestic) and Issuer Outlook
Bank	BCA	Adj BCA	LGF uplift			
Powszechna Kasa Oszczednosci Bank Polski S.A.	baa2	baa2	2	1	A2/P-1/STA	
PKO Bank Hipoteczny	-	-	-	-	Baa1/P-2/STA*	
Bank Polska Kasa Opieki S.A.	baa1	baa1	2	0	A2/P-1/STA	
Santander Bank Polska S.A.	baa3	baa2	2	0	A3/P-2/POS	
ING Bank Slaski S.A.	baa2	baa1	2	0	A2/P-1/STA	
Credit Agricole Bank Polska S.A.	ba2	baa3	2	0	Baa1/P-2/STA	
Bank BGZ BNP Paribas S.A.	ba2	baa3	2	0	Baa1/P-2/STA	
mBank S.A.	ba1	baa3	2	0	Baa1/P-2/POS	
Bank Millennium S.A.	ba1	ba1	2	0	Baa2/P-2/POS	
Getin Noble Bank S.A.	caa1	caa1	2	0	B2/NP/NEG	

Slovakia		A2 - Positive Outlook			Government Support	Deposit Rating (Domestic) and Issuer Outlook
Bank	BCA	Adj BCA	LGF uplift			
Vseobecna uverova banka, a.s.	baa2	baa2	2	1	A2/P-1/STA	
Ceskoslovenska obchodna banka (Slovakia)	ba1	baa2	2	0	Baa1/P-2/STA	
Tatra banka, a.s.	baa3	baa3	2	1	A3/P-2/STA	
Slovenska sporitelna, a.s.	baa2	baa1	1	1	A2/P-1/STA	

Slovenia		Baa1 - Stable Outlook			Government Support	Deposit Rating (Domestic) and Issuer Outlook
Bank	BCA	Adj BCA	LGF uplift			
Nova Ljubljanska banka d.d.	ba1	ba1	2	0	Baa2/P-2/POS	
Abanka d.d.	ba1	ba1	2	0	Baa2/P-2/POS	
Nova Kreditna banka Maribor d.d.	ba2	ba2	2	0	Baa3/P-3/POS	

Note: *Issuer rating

Source: Moody's Investors Service



Note: The numbers signify the number of banks we rate in each country

Hungary		Baa3 - Stable Outlook			Government Support	Domestic Deposit Rating and Outlook
Bank	BCA	Adj BCA	LGF uplift			
OTP Bank NyRt	ba1	ba1	2	0	Baa2/P-2/STA	
OTP Jelzalogbank Rt	-	-	-	-	Baa3/STA*	
Kereskedelmi & Hitel Bank Rt.	ba3	ba1	2	0	Baa2/P-2/POS	
Budapest Bank Rt.	b1	b1	2	0	Ba2/NP/STA	
Erste Bank Hungary Zrt.	ba3	ba1	2	0	Baa2/P-2/POS	
Takarek Mortgage Bank Co. Plc.	b1	b1	0	1	Ba3/NP/POS	
MKB Bank Zrt.	caa1	caa1	2	0	B2/NP/STA	
MFB Hungarian Development Bank Ltd	-	-	-	-	Baa3/P-3/STA*	

Romania		Baa3 - Stable Outlook			Government Support	Domestic Deposit Rating and Outlook
Bank	BCA	Adj BCA	LGF uplift			
BRD - Groupe Societe Generale	ba2	ba1	2	0	Baa2/P-2/POS	
Banca Comerciala Romana S.A.	ba3	ba1	2	0	Baa2/P-2/POS	
Raiffeisen Bank SA	ba1	baa3	2	0	Baa1/P-2/STA	
Alpha Bank Romania S.A.	b2	b2	2	0	Ba3/NP/POS	

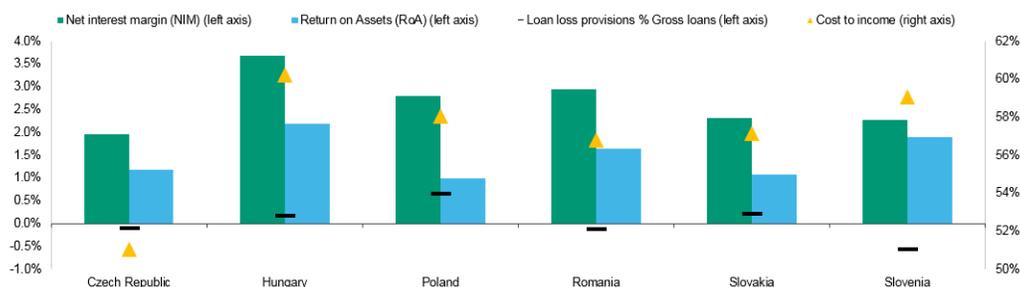
Profitability will remain under pressure

- » Low interest rates and sizable regulatory costs will constrain revenues. Normalizing credit costs will also pressure earnings.
- » Banks aim to soften the impact through lending growth, particularly in higher-yielding but riskier SME and consumer segments.
- » Profitability for CEE banks will remain higher than the average for European banks.

Exhibit 5

Loan-loss provisioning needs will likely rise from lower than normal levels

Profitability ratios as of H1 2018



Note: Data for rated banks. Data for Romania as of Dec 2017 since H1 2018 are not available for rated banks.

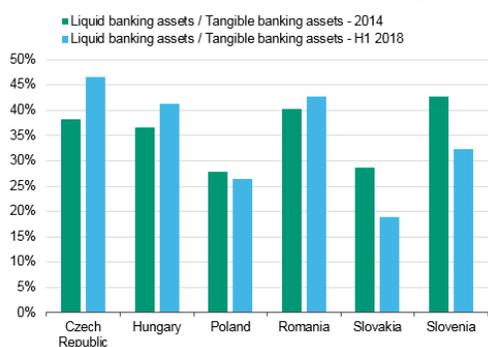
Source: Moody's Investors Service

Access to funding and liquidity is strong

- » CEE6 banking systems are primarily funded by stable and low-cost customer deposits, a credit strength.
- » Loan growth is eroding liquidity buffers at some banks, but they remain high nonetheless
- » Banks' reliance on costlier and more volatile market funds will gradually increase as they prepare to meet rising regulatory requirements, including a layer of bail-in debt (MREL).

Exhibit 6

Liquidity buffers remain high across the region

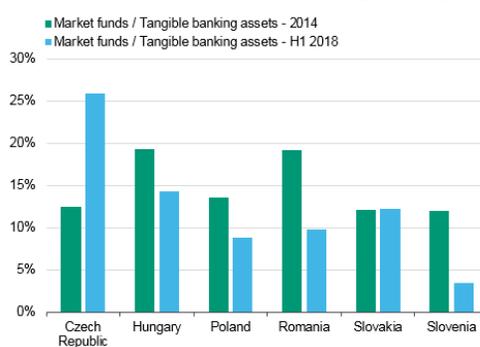


Note: Data based on rated banks. Data for Romania as of Dec 2017 since H1 2018 are not available.

Source: Moody's Investors Service

Exhibit 7

Banks' reliance on market funds will gradually rise



Note: Czech banks' higher market funds reliance is due to carry trades by foreign banks to benefit from the Czech koruna - euro interest rate differential. Data based on rated banks. Data for Romania as of Dec 2017.

Source: Moody's Investors Service

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IN THIS ISSUE

Auto tariffs would marginally dampen growth in CEE sovereigns, but credit implications are limited

Originally [published](#) on 03 September 2018

The US (Aaa stable) commerce department is currently conducting a review of whether auto imports harm national security, which could see the US impose 25% tariffs on vehicles and parts imports before the end of the year. For now, we assume that the US trade measures affecting the EU will ultimately stop short of full implementation given the outcome of the meeting between US President Donald Trump and EU President Jean-Claude Juncker on 25 July 2018. However, there is a risk that this may only be a temporary de-escalation of trade tensions and that the full extent of the auto tariff measures under considerations may be implemented.

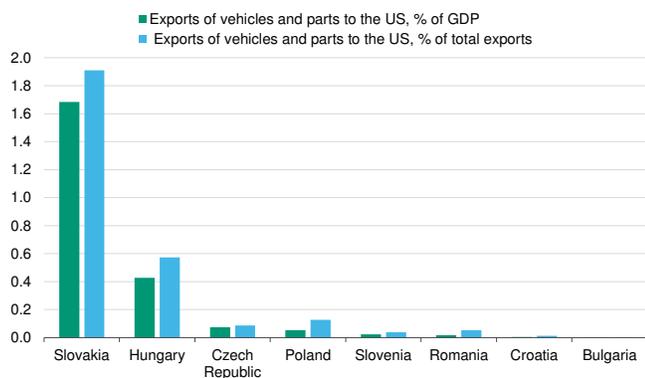
We estimate that 25% tariffs on vehicles and parts would shave less than 0.1 percentage points (pps) off our current growth forecasts for the Central and Eastern European (CEE) countries¹ in 2019. The impact would be felt most in [Slovakia \(A2 positive\)](#) (-0.2 pps) and [Hungary \(Baa3 stable\)](#) (-0.1 pps). Given that this slight deceleration in growth would only marginally impact fiscal metrics, auto tariffs are unlikely to have any credit implications.

However, an intensification of global trade tensions that includes sizeable tariffs on a broader range of goods and non-tariff barriers to trade and that weighs on global growth would generate stronger headwinds for the region. Based on the importance of exports to the economy and the share of foreign value added, [Slovenia \(Baa1 stable\)](#) would be most exposed to such a shock, followed by Slovakia, Hungary and the [Czech Republic \(A1 positive\)](#). However, Hungary's credit profile is most vulnerable given its more limited policy flexibility and higher debt burden.

US tariffs on vehicles and parts would marginally weigh on CEE growth, but have no sovereign credit implications

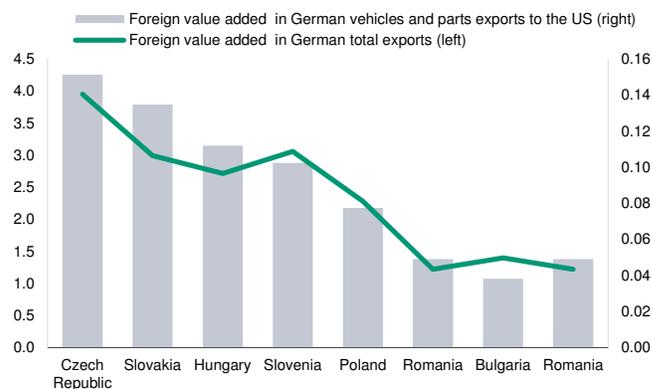
Within the CEE, the economies of Slovakia, Hungary and the Czech Republic are most dependent on auto exports (22% of GDP, 12% and 17%, respectively). The auto sector also contributes 4.3%, 5.2% and 5.6% of gross value added, respectively. Region-wide, it accounts for 4.7% of gross value added.

Exhibit 1
Slovakia, Hungary and Czech Republic are most exposed to US demand for vehicles and parts...
2017 or latest available year



Sources: UN Comtrade, Moody's Investors Service

Exhibit 2
... and to demand fluctuations within German supply chains
% of GDP of the respective country, 2017 or latest available year



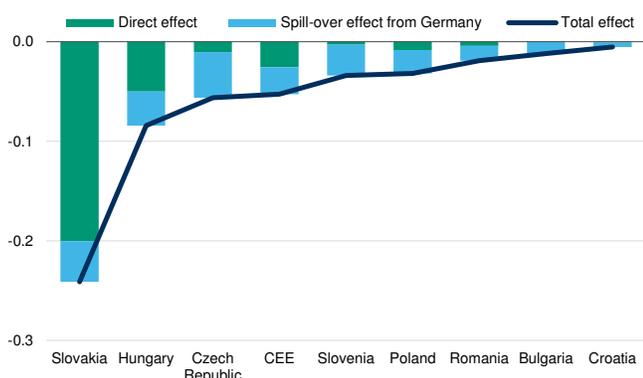
Sources: UN Comtrade, OECD, IMF, Moody's Investors Service

However, exposures to the US market are much lower as direct exports of vehicles and parts to the US from Slovakia, Hungary and the Czech Republic account for 1.7%, 0.4% and 0.1% of GDP, respectively (Exhibit 1). These exposures increase when we incorporate their

integration into [Germany's \(Aaa stable\)](#) automotive value chains: German companies typically cut production and employment in their foreign affiliates first as a response to a demand shock.² Again, the Czech Republic, Slovakia and Hungary are most exposed indirectly (Exhibit 2).

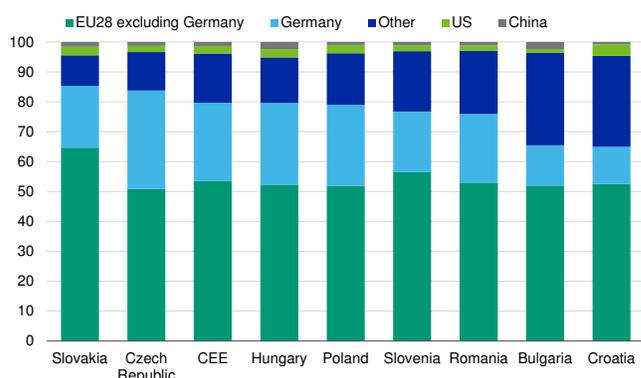
We estimate a 25% tariff would shave less than 0.1 percentage points off the 3.6% CEE GDP growth we currently forecast for 2019. This is based on our estimate of the direct impact on US demand³ and the negative spill-over effects from Germany (the latter accounts for roughly half of the overall effect).⁴ By country, we estimate tariffs would shave 0.2 pps off Slovakia's growth, almost 0.1 pps for Hungary and below 0.1 pps in other CEE countries. Among CEE countries, the direct effect would only surpass the spill-over effects from Germany in Slovakia and Hungary (Exhibit 3).

Exhibit 3
Slovakia's growth would be most affected by US tariffs on vehicles and parts
Percentage point loss of GDP compared to 2019 baseline GDP forecast



Sources: UN Comtrade, OECD, Moody's Investors Service

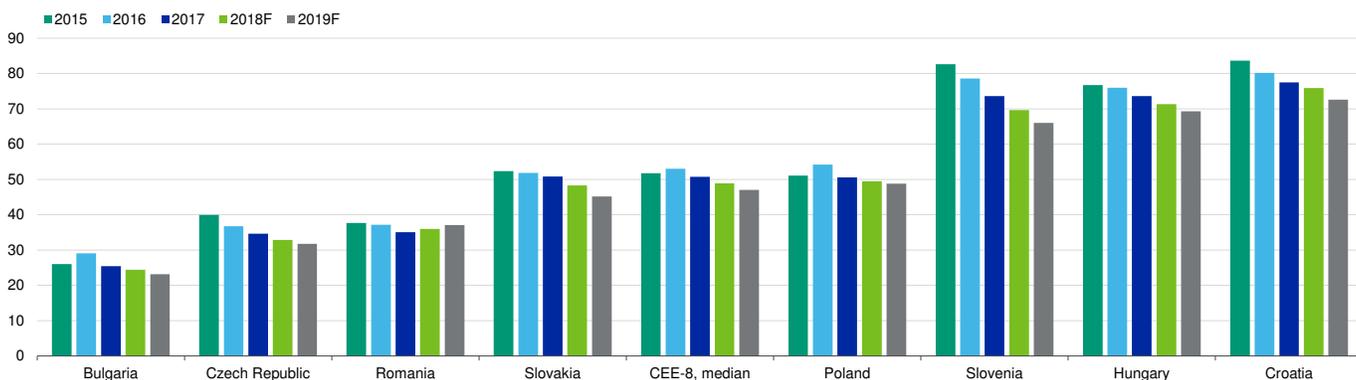
Exhibit 4
CEE exporters are more dependent on EU rather than US demand
% of total exports, 2017 or latest available year



Sources: UN Comtrade, Moody's Investors Service

Overall, this only slight deceleration in growth would have marginal consequences for fiscal metrics. As a result, we would still expect the CEE's median debt ratio to decline gradually in the coming years (Exhibit 5) under that scenario.

Exhibit 5
We would still expect debt burdens to gradually fall in 2018 and 2019
% of GDP



Sources: Eurostat, Moody's Investors Service

Our estimates do not account for the potential impact these tariffs and the threat of further measures could have on corporate investment beyond what we currently forecast from weakening confidence indicators in the manufacturing sector. That said, we expect the effect of 25% tariffs on growth would be marginal over the longer term. Some of the traditional buyers of European cars could

permanently change their consumption pattern in favor of US car manufacturers because of tariff related changes in relative prices. But the overall demand for cars is relatively inelastic over the long-run as cars are goods being essential to everyday living.⁵

Broader escalation of global trade tensions would generate stronger headwinds; Hungary most vulnerable given its credit challenges

Trade tensions between the US and EU coincide with US trade disputes with [China \(A1 stable\)](#). Any intensification of trade disputes with sizeable tariffs on a broader range of goods and non-tariff barriers that would weigh on global growth pose more sizeable downside risks to CEE countries.

CEE countries would largely be affected via their exposures to the to slower EU growth where almost 80% of their total exports went in 2017 (26% to Germany, 53% to EU countries other than Germany), compared to 2% to the US, 1% to China and 16% to other countries (Exhibit 4). We assess the sensitivity of each CEE country according to the importance of exports to the wider economy (exports as a % GDP) and the foreign value added share of their exports.

Based on severe downside scenario in which exports fell 10 percentage points (pps), we expect GDP growth would decline most in Slovenia (-5.4 pps), followed by Slovakia (-5.0 pps), Hungary (-4.7 pps) and Czech Republic (-4.2 pps). The lowest decrease would be seen in Poland (-3.6 pps) and Romania (-3.1 pps). The assumed fall in exports is somewhat weaker than the slump in exports in OECD countries in 2009 (-10.7% year-on-year; EU 28: -11.6%; euro area: -12.3%). Czech Republic, Slovenia, Slovakia and Hungary are also the most exposed to German supply chains, having delivered intermediate goods to German exporters worth 4%, 3.1%, 3.0% and 2.7% of their respective GDP in 2017 (Exhibit 2).

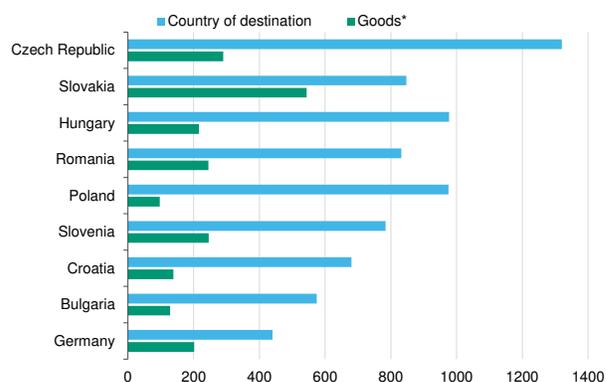
That said, diversification of exports by country of destination and by goods enhances a country's resilience to specific regional or goods specific shocks. By country, Czech Republic and Hungary have the least diversified export structures among CEE largely due to their high share of exports to Germany. By goods, Slovakia's and Czech Republic's exports are the least diversified because of the high share of vehicles and parts exports (Exhibit 7). Therefore, those countries are more exposed to a regional or goods-specific decrease in external demand.

Exhibit 6
Slovenia and Slovakia most exposed to trade shock % , 2017 or latest available data



Source: World Bank, OECD, Moody's Investors Service

Exhibit 7
Slovakia's exports are least diversified by goods and the Czech Republic's by destination Herfindahl-Hirschman Index (HHI), sorted by the average of HHI country of destination and HHI goods



*Harmonized System: four-digit code (1260 categories)
Sources: UN Comtrade, Moody's Investors Service

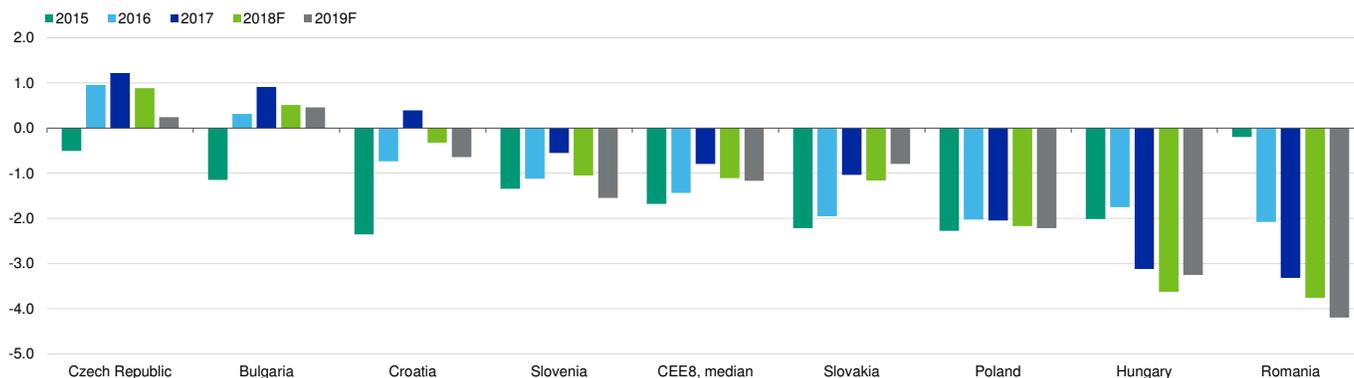
However, the credit implications of such a shock for each sovereign would depend on the country's economic resilience, the sovereign's fiscal position as well as its ability and willingness to introduce effective policy responses. The four most exposed CEE countries all show economic growth that is significantly above potential and very tight labor markets. The fiscal situation is the most favorable in the Czech Republic and Slovakia, which have low debt burdens and healthy structural fiscal balances (Exhibits 5 and 8). Hungary shows the weakest fiscal position among the four most exposed CEE countries. Based on our assessment of institutional strength, the Czech

Republic is best placed and Hungary worst placed among the four most exposed CEE countries to introduce policy responses to cushion the negative effect of a large shock. As a result, among the four most exposed CEE countries, the Czech Republic is in our view better equipped to withstand an external trade shock, followed by Slovakia, Slovenia and Hungary.

Exhibit 8

Structural balances vary widely in CEE with the Czech Republic and Bulgaria showing a surplus in 2018 and 2019

Structural balance of general government, % of potential GDP



Sources: European Commission, AMECO, Moody's Investors Service

Endnotes

1 [Bulgaria \(Baa2 stable\)](#), [Croatia \(Ba2 stable\)](#), [the Czech Republic \(A1 positive\)](#), [Hungary \(Baa3 stable\)](#), [Poland \(A2 stable\)](#), [Romania \(Baa3 stable\)](#), [Slovakia \(A2 positive\)](#) and [Slovenia \(Baa1 stable\)](#).

2 <https://ideas.repec.org/a/jns/jbstat/v233y2014i4p505-525.html>

3 Our estimate of the direct effect is based on (1) the [short-term price elasticity of demand for automobiles of 1.35](#) reflecting US consumers buying more domestic US car manufacturers as a consequence of the tariff-related increase of car prices and postpone their car purchases; (2) 52% of total CEE auto exports (median) consisting of imported intermediate goods (foreign value added share), which mitigates the impact on CEE.

4 https://www.moodys.com/research/Government-of-Germany-Auto-tariffs-would-dampen-German-growth-somewhat-Issuer-In-Depth--PBC_1131788

5 From a sovereign perspective, the more substantial longer-term challenge for CEE auto manufacturers will be fundamental changes in the car industry like more stringent environmental standards, as well as adjustment challenges posed by the shift to electric and autonomous mobility (see also "[Auto sector transformation will drive global multi-sector credit trends](#)").

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IN THIS ISSUE

Romania's bank tax is credit negative for banks and the sovereign

Originally [published](#) on 25 February 2019

A bank tax imposed on Romanian banks at the start of this year will reduce the banks' profitability, limit their internal capital generation and restrict their ability to extend loans to the real economy, a credit negative. The tax is also negative for the government since it will be detrimental for business environment, particularly in view of similar tax hikes on utilities and telecommunications companies. Heightened policy unpredictability in the country is also likely to deter investors.

The bank tax was passed by the government late last year using an emergency procedure that bypassed parliament and the president. It is the latest in a series of measures taken in late December by the Romanian authorities that are credit negative for the banks.

While it has been watered down from its initial form, it continues to attract criticism from the business community, the Romanian National Bank, the European Central Bank, and private and public investors, including the [European Bank for Reconstruction and Development](#) (EBRD, Aaa stable) and the [International Finance Corporation](#) (IFC, Aaa stable), a member of the World Bank.

Much of the criticism focuses on the fact that the bank tax is linked to the Romanian Interbank Offered Rate or ROBOR, the local interbank lending rate, which is a benchmark for pricing loans. The link to ROBOR interferes with the effective functioning of the money markets, according to the central bank, and may compromise the effectiveness of monetary policy.

We anticipate the tax will amount to around 0.3% of assets

The first payments of the new tax are due in April and will be based on 31 March 2019 balance sheets. The method of calculation remains uncertain, however. How the average of three- and six-month ROBOR will be calculated has not been clearly defined. Neither has the asset base to which the tax will apply. The tax's application on key items such as reserves with the central bank, loans in foreign currency and banks' investments in T-bills is still being debated with the central bank.

Based on the government's current proposal and the most recent three- and six-month ROBOR, we estimate the tax will be around 0.3% of financial assets, raising rated banks' effective tax rate to around 35%¹ almost double the 16% corporate tax rate.

Exhibit 1

Current proposed bank tax

ROBOR average*	Rate	Tax base
2.0%-2.5%	0.1%	Financial assets
2.5%-3.0%	0.2%	Financial assets
3.0%-3.5%	0.3%	Financial assets
+0.5%	+0.1%	Financial assets

Note: *ROBOR average is based on ROBOR rates at three months and six months, computed and published by the National Bank of Romania for the last quarter/semester prior to the quarter of computation.

Sources: Ernst & Young tax news update, Official Gazette and media reports

The higher tax rate will hurt banks' profitability...

We expect the banks to pass on part of the cost to consumers. Nevertheless, we consider the higher tax rate will reduce their profitability, particularly if the tax is permanent as the government envisions. The bank tax will likely also curtail economic activity, a credit negative for the sovereign, since it will likely constrain bank financing for infrastructure projects and businesses.

Among the rated banks best positioned to absorb the tax are [Banca Comerciala Romana S.A.](#) (BCR, Baa2 positive, ba3²) and [BRD - Groupe Societe Generale](#) (BRD, Baa2 positive, ba2). These two banks display the highest profitability with return on assets of 2.0% at BCR as of June 2018 and 2.8% at BRD in September (Exhibit 5). The country's smaller banks have weaker earnings capacity and the burden will therefore be relatively larger. The tax will also distort the competitive landscape since it applies only to banks, excluding other credit-providing financial institutions.

Exhibit 2

The bank tax will have a moderate impact on the banks' profitability

Rated bank	RoA (latest)	Bank tax	RoA (after bank tax)
Banca Comerciala Romana	2.0%	0.3%	1.7%
Raiffeisen Bank SA	1.4%	0.3%	1.1%
Alpha Bank Romania S.A.	1.4%	0.3%	1.1%
BRD - Groupe Societe Generale	2.8%	0.3%	2.5%

Note: RoA = return on assets; Latest available data for Raiffeisen and Alpha Bank as of Dec-2017; for BCR as of June-2018 and for BRD as of Sep-2018

Sources: Banks' financial statements and Moody's Investors Service

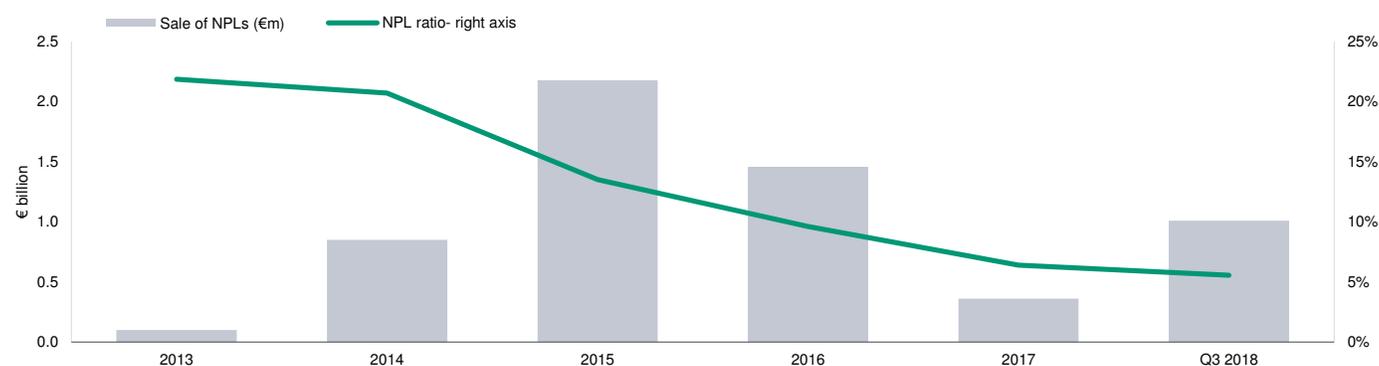
...and may weaken the momentum of the market turnaround

Romanian banks were hit badly in the financial crisis but have started to recover in recent years. Profitability improved over the first nine months of 2018, with a sector-wide return on assets of 1.8%, up from 1.3% for full year 2017, driven by low funding and provisioning costs.

Stocks of problem loans stood at 5.6% of total loans as of September 2018, down from 22% as of December 2013 (Exhibit 6), helped by loan restructurings, write-offs and sales. The banking sector has sold around €6 billion of nonperforming loans to foreign and domestic investors over the last five years. Given new constraints on recoveries from problem loan sales, we expect more limited investor demand over the coming quarters.

Exhibit 3

NPL sales over the past five years have contributed to a significant improvement in asset quality



Sources: Bank information, Vienna-Initiative (NPL Monitor research) and Moody's Investors Service

The government's unpredictable policy-making will also likely reduce Romania's appeal to investors. The business community has expressed concerns about the signal sent to the markets, against a backdrop of similar tax hikes for utilities and telecommunications companies.

The day the bank tax was announced, bank stock prices plunged, bringing the stock exchange index to its lowest point since December 2016.

The aim of the bank tax is to raise government revenues

The debate in Romania over the imposition of a bank tax comes at a time of weakening public accounts. The fiscal deficit reached 2.9% of GDP in 2016 and 2017. In December 2018, the fiscal deficit was 27.3 billion lei (\$6.5 billion), or 2.9% of GDP, according to the Ministry of Finance.

Budget revenue and expenditure increased by 17.2% and 16.8% respectively in 2018. Social assistance dominated the expenditure side, representing 31.4% of total expenditure. The revenue side was boosted by ROL3.87 billion (0.4% of GDP) of European Union funding in December under the EU's stability and convergence programme. While the national accounts annual outcome is still to be announced, budget execution in 2018 signals a still weak position and limited fiscal room to respond to any unforeseen circumstances.

The 2019 budget represents a slight fiscal tightening. It targets a fiscal deficit of 2.8% of GDP, supported by somewhat optimistic estimates of real GDP growth of 5.5% and inflation of 2.8%. The budget forecasts a 15.7% increase in revenue in 2019, reaching 33.4% of GDP, possibly relying on provisions from the banking tax and changes to the private pension sector. If revenues fall short, further spending cuts would appear unlikely due to presidential elections scheduled for later this year. Expenditure is estimated at 35.9% of GDP, mainly driven by spending on social assistance and personnel expenses.

Other Central and Eastern European countries have imposed a bank levy

Three other countries in Central and Eastern Europe have introduced a bank levy. They are Hungary, Poland and Slovakia (Exhibits 2,3 & 4) which introduced a flat tax ranging between 0.2% to 0.44% of assets. The Romanian government is the only one to link the tax to the interbank reference rate, however.

The Romanian National Bank has criticised the link, arguing that the move will compromise the sound functioning of the money markets and the transmission mechanism of monetary policy. This is because any central bank decision to hike the benchmark interest rate will be passed across to the interbank rate, sending the bank tax higher. On 4 February, the government and central bank established a working group to examine the impact of the bank tax and potentially establish a different calculation method.

Exhibit 4

Bank levy, Slovakia

Period	Rate	Tax base
(Initial) Bank tax since January 1, 2012	0.40%	Liabilities - own equity – protected deposits
(Increased) Bank tax since September 1, 2012	0.40%	Liabilities - own equity
Special (extra) bank tax only in 2012	0.10%	Liabilities - own equity
2015-2020	0.20%	Adjusted liabilities (total liabilities less own funds and subordinated debt)
2021 onwards	0%	

Sources: Moody's Investors Service, Reuters, PWC pocket tax book 2018 and media reports

Exhibit 5

Bank levy, Hungary

Period	Rate	Tax base
From a tax base up to HUF50 bn		
From 2010	0.15%	adjusted balance sheet
From a tax base exceeding HUF50 bn		
From 2010-2015	0.53%	adjusted balance sheet
2016	0.31%	adjusted balance sheet
2017-2018	0.21%	adjusted balance sheet
2019 onwards	0.20%	adjusted balance sheet

Note: Tax implemented from 27.9.2010; adjusted balance sheet is bank assets minus domestic interbank loans and securities issued by other domestic credit institutions
Sources: Moody's Investors Service, Reuters and media reports

Exhibit 6

Bank levy, Poland

Period	Rate	Tax Base
From a tax base up to PLN4 billion		
From 2016	0.44%	adjusted assets

Note: Adjusted assets refers to Assets minus own funds, with the first PLN4 billion tax-free. It excludes Treasury securities and the bills issued by the Polish National Bank, which are pledged under refinancing operations with the same institution

Sources: Moody's Investors Service, Ernst & Young tax alert

The bank tax is the latest in a series of negative measures facing the banks

The tax on Romanian banks is the latest in a series of measures taken in late December by the Romanian authorities which are credit negative for banks. Other measures include capping the interest rate on consumer loans and limiting the value that can be

recovered from sales of problem loans. We have limited visibility concerning these measures, however we think it is likely they will be implemented soon given that they have been endorsed by Parliament.

The legislation capping the interest rate banks can charge for consumer loans to 18% has been amended to also cap the maximum interest rate for consumer loans of up to an equivalent of €3,000 at 50%. Although consumer loans and mortgages account for only 40% of total loans, limiting the banks' pricing power may reduce their net interest margins as well as potentially distort risk adjusted returns.

Lawmakers have also weakened the banks' ability to recover nonperforming exposures by forcing banks to obtain a court decision regarding the legal rights to execute the loan agreement before initializing recovery procedures. Although Romanian courts are reasonably efficient, this requirement will introduce additional stress on the legal system, lengthen the recovery procedure and will reduce recovery rates.

Finally, the parliament has passed legislation which caps the amount that buyers of nonperforming loans can recover from the borrower at twice the amount they paid to the initial creditor. For example for nonperforming, unsecured consumer loans, which are usually sold at steep discounts, transactions can take place with prices as low as 5% of the loan amount. The new law will mean that the recovered amount will be limited to 10% of the loan amount. We expect this to significantly reduce investor appetite for Romanian unsecured retail problem loans.

Endnotes

- 1 Calculated as domestic statutory tax rate for income tax at 16% and estimate for bank tax around 20% (excluding other taxes, impact of other elements, tax exempt items) as a percentage of profit before income tax.
- 2 The bank ratings shown are the bank's domestic deposit rating, Baseline Credit Assessment and outlook.

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IN THIS ISSUE

CEE bank CFOs are more cautious on growth; regulatory changes pose challenges

Originally [published](#) on 20 February 2019

Chief financial officers (CFOs) of banks in Central and Eastern Europe (CEE) expect stable loan performance and capital this year, according to our 2019 CEE CFO survey. They were more cautious, however, about business confidence and credit demand than last year. Regulatory changes and digital investments also pose challenges. Our survey covered banks we rate in the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. We quizzed CFOs on their views about the operating environment, financial factors, growth opportunities and financial technology (fintech). In all, 26 CFOs responded, representing banks with more than 40% of banking assets, on average, in the six countries.

- » **Benign macroeconomic conditions will likely continue.** Most CFOs expect business confidence to remain unchanged in 2019, reflecting continued strong economic growth in the region. Nonetheless, 30% expect some deterioration over the next 12 months, up from only 5% in 2018. Changing demographics as a result of an ageing population and labour force emigration are contributing to higher staff costs.
- » **Loan growth will slow as credit demand eases.** Almost 90% of CFOs anticipate loan book growth this year, but only 31% expect rising credit demand, down from 70% in 2018. Some 92% of the survey respondents characterised lending competition as high, whereas only 12% cited strong competition in deposit collection.
- » **Regulation is the main constraint on banks' development.** Some 38% of respondents said regulatory changes are creating uncertainty in their operations. Most CFOs expect banking regulation to tighten, driven by European Union (EU) rules and credit growth in local markets.
- » **Most CFOs expect stable loan quality and capital, but are cautious on profit.** Some 56% of the CFOs who responded expect problem loan levels to stagnate in 2019, while 64% believe their banks' capital adequacy will remain stable this year. However, half of the respondents expect a lower return on equity in 2019.
- » **Banks continue to invest in IT, mainly to enhance user experience.** The majority of respondents expect fintech to affect retail banking and payment services most. Only 12% of CFOs see big tech companies entering the region's banking market as a significant threat.

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IN THIS ISSUE

NET4GAS, s.r.o.: Part of the strategic route for gas transit from Russia to Western Europe

Originally [published](#) on 30 January 2019

New Baa2 senior unsecured ratings assigned

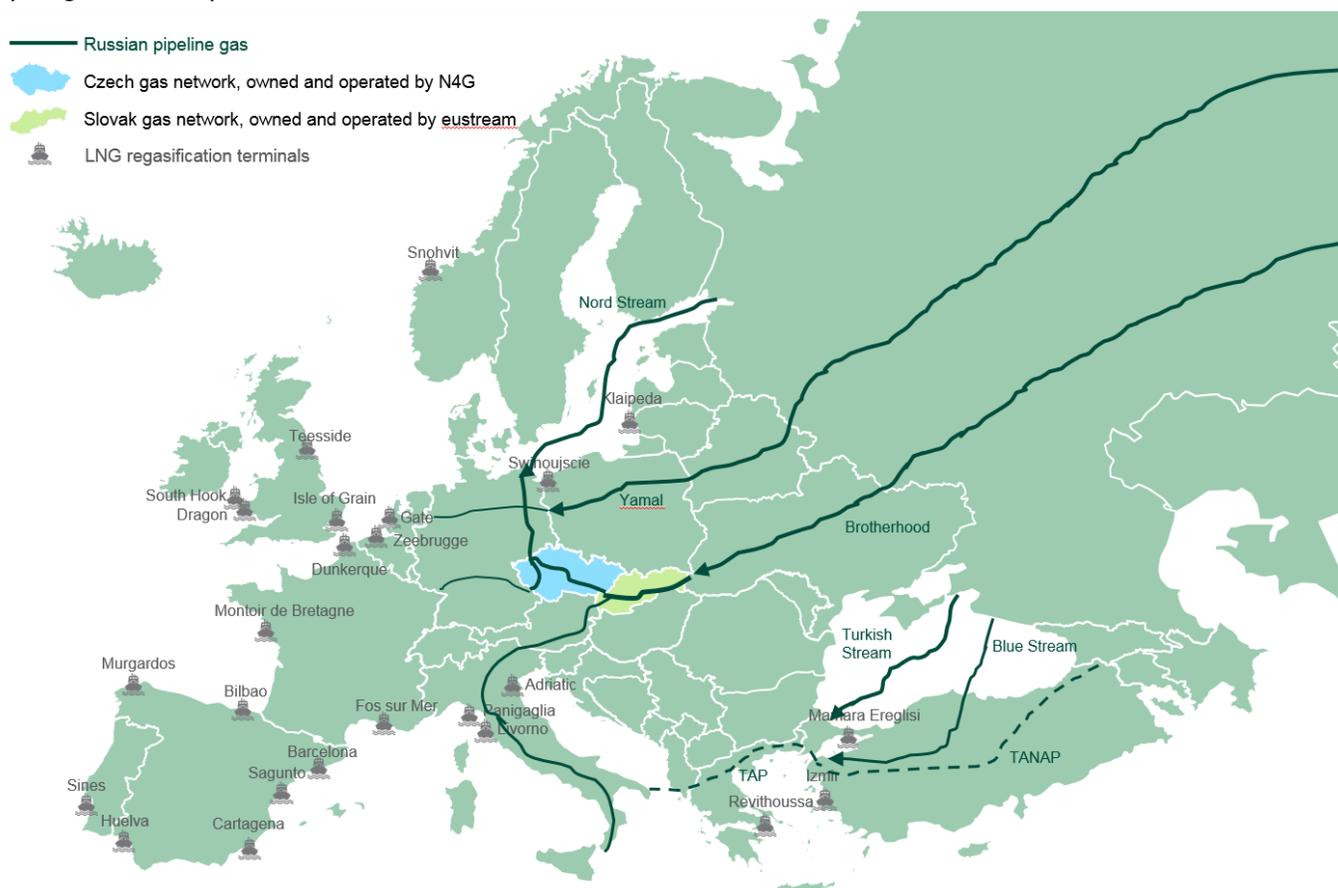
On 28 January 2019, we assigned first-time Baa2 issuer and senior unsecured debt ratings to NET4GAS, s.r.o. (N4G), the owner and operator of the Czech gas transmission system.

Our assessment of N4G's credit quality takes into account the following credit considerations:

- » **Monopoly provider of gas transmission and transit services in the Czech Republic, with strategic location along the preferred route for shipping Russian gas to Western Europe.** N4G's core business consists of transporting gas, primarily sourced from Russia, towards Western and Southern Europe under long-term contracts. It is also the regulated domestic gas transmission network operator under an unlimited licence.
- » **Stable and predictable cash flow generation.** Long-term capacity ship-or-pay contracts underpin around 75-80% of revenues, while regulated tariffs for domestic monopoly transmission activities account for the remaining 20-25% of revenues.

Exhibit 1

European gas market map



Source: International Energy Agency, Moody's

- » **Significant customer concentration and associated geopolitical risks constrain credit quality.** The majority of N4G's revenues are generated from non-EU countries and primarily concentrated on a single customer, namely Gazprom Export LLC, a 100% subsidiary of Gazprom, PJSC. While ongoing tensions between Russia and Ukraine have had limited impact on N4G's transported volumes to date, any future global sanctions on Russia may impact the interaction with Russia and its companies.
- » **Large capital investment projects to extend N4G's transit capacity,** scheduled over the next five years. However, funding risk is reduced by strong shareholder commitment to provide equity support for the two main capital expenditure projects, which will support maintenance of current credit quality.
- » **Materially higher leverage than exhibited by other European gas transit peers,** in particular Slovak pipeline owner, eustream, a.s. (Baa2 stable). However, such gearing can be accommodated at current rating levels, because N4G is less exposed to the geopolitical tensions around the East-West route for Russian gas shipments through the Ukraine, and benefits from more predictable cash flows under generally longer term ship-or-pay transit contracts as well as a much larger portion of regulated transmission tariffs.

Exhibit 2

Overview of the company's network and entry/exit capacities



Note: The numbers in the map above indicate the maximum daily capacity at each border station and arrows indicate the direction of flow.

Source: Company's 2018 bond prospectus

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IN THIS ISSUE

Results of first capacity auction are credit positive for state-owned electricity generators in Poland

Originally [published](#) on 27 November 2018

On 20 November, Poland's state transmission system operator Polskie Sieci Elektroenergetyczne SA (PSE) published the conditional results of its first power capacity auction, in which electricity producers are paid for their readiness to provide electricity when needed.

The auction results are credit positive for state-owned generators, [PGE Polska Grupa Energetyczna S.A.](#) (PGE, Baa1 stable), TAURON Polska Energia S.A., Enea S.A. and [ENERGA S.A.](#) (Baa1 stable) because the payments they will receive as a result of the capacity awards will provide them with a steady revenue stream.

This is particularly important because of Poland's heavy reliance on coal, with several new thermal plants under construction. These new plants have high capital costs and the longer term contracts will provide much needed support to underpin their earnings. However the new plants will also generate more in the wholesale market than existing plant, because they will have lower variable costs. Earnings from the wholesale market will provide an additional revenue stream to generators. Contracts for modernised plants will keep certain units available which would otherwise have been decommissioned.

As Exhibit 1 shows, of the 22.4 gigawatts (GW) auctioned for delivery in 2021, Poland's largest generator, PGE, won the largest amount in absolute terms and in terms of coverage of expected capacity in 2021.

Exhibit 1

PGE won the biggest capacity award in the first auction

Awarded capacity in MW

Awarded capacity unit types

	Total awarded	Proportion of 2021 expected capacity	Existing	Modernised	New	Demand side
PGE	11,652	67%	7,009	2,698	1,944	0
ENEA	3,663	59%	952	2,711	0	0
Tauron	2,672	55%	422	1,474	773	4
Energa	977	59%	242	585	0	150
Other	3,463	N/A	1,648	48	1,305	461
Total	22,427	N/A	10,274	7,516	4,022	615

Proportion of 2021 expected capacity does not include capacity awarded in respect of the demand side units.

Existing units awarded one-year contracts with the exception of one Enea plant which was awarded a 15-year contract; modernised units awarded five-seven year contracts; new units awarded 15-17 year contracts. All contracts start in 2021.

Sources: PSE, Companies

The contracts for existing plants are only for a year. However this is the first of three auctions to be held this year, with the next two auctions for capacity delivery in 2022 and 2023. Further auctions in 2019 will be for 2024 delivery. There will also be smaller auctions of extra capacity of around 1-3GW for quarterly allocations.

The capacity obligation price for the multiyear agreements will be adjusted annually with the annual average consumer price index. Remuneration for new or modernised units will also be lowered by the amount of any public aid granted to these investments.

PGE's and Energa's share of their total capacity awarded is sizeable, because there are significant penalties if plant availability is less than plant owners have contracted to deliver. PGE's thermal units under construction — that is, new capacity — received a full allocation of net achievable capacity, subject to a 91.54% availability factor.

PGE has three hard coal and lignite plants under construction with a total capacity of 2.3GW due to be commissioned in 2019 and the new 1GW Ostrołęka C plant, due for completion in 2023, owned jointly by Energa and Enea, will add to increased capacity. Energa has said the companies will enter this plant in the capacity auctions for 2023.

Based on the clearing price of PLN240.32/kW a year, we estimate that PGE could benefit from PLN2.8 billion of payments in 2021 from this first auction. This is substantial when compared with PGE's total 2017 EBITDA of PLN7.6 billion, of which PLN4 billion was derived from the generation segment. Energa's capacity payments could be in the region of PLN0.2 billion, which compares with PLN2.2 billion total EBITDA in 2017, of which PLN0.4 billion was from generation.

While capacity payments are positive for generators, they will have to bear increasing costs in their generation business during the next few years. Carbon dioxide (CO₂) linked costs are set to rise because the number of free EU carbon emission allowances Polish generators are awarded is decreasing and are scheduled to be eliminated by 2020, while the price of allowances has risen substantially in 2018. Power prices in Poland have rallied in recent months, reflecting higher CO₂ prices. However in the longer term the stabilising effect of capacity payments and increased supply from new and modernised units, as well as more renewables coming on stream, will probably damp prices.

Although capacity arrangements have passed into law in Poland (Ustawa o rynku mocy) and were approved by the European Commission in February 2018 under EU State Aid rules, they are in contrast to the Winter Package proposals which seek to limit eligibility of high CO₂ emission plants for capacity mechanisms. Polish law may therefore need to be amended in due course to align it with EU legislation, when finalised. There is a risk that longer-term contracts may be affected, although generators may legally be able to retain rights already acquired.

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IN THIS ISSUE

Reduction in nonperforming loans is credit positive for Bulgarian banks

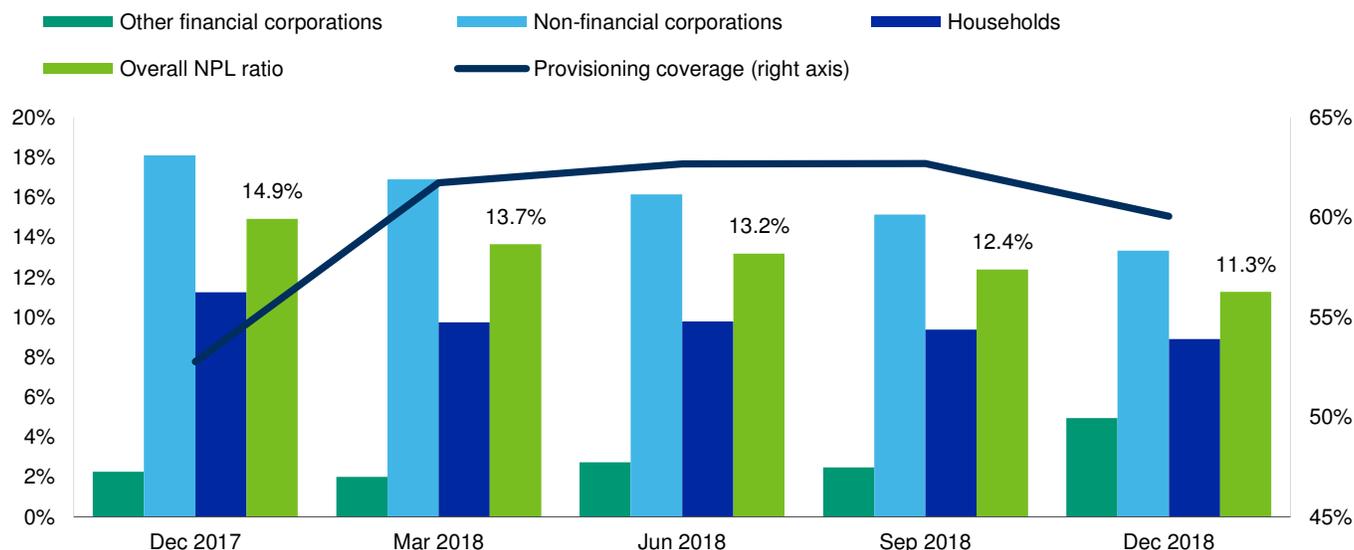
Originally [published](#) on 06 February 2019

On 31 January, the Bulgarian National Bank (BNB), the central bank, published data that showed nonperforming loans (NPLs) and advances¹ continued to decline over 2018, both in absolute terms and relative to gross loans, a credit positive for the country's banking system.

NPLs declined by the equivalent of €770 million in 2018, including a €309 million fall in the fourth quarter alone. The banking system's NPL ratio was a still-high 11.3% as of the end of 2018, but this was down from 14.9% a year earlier, with provisioning coverage at 60% (see exhibit). Most of the improvement was driven by corporations, which account for the bulk of NPLs at 69%, while overall loans to this segment make up 58% of the total. Profit in the banking sector was also up by around 40%, following a 35% reduction in loan impairment costs during 2018.

Bulgarian banks' nonperforming loans continued to decline in 2018

Evolution of the ratio of NPLs to gross loans by segment and coverage in Bulgaria



Sources: Bulgarian National Bank and Moody's Investors Service

The continuing improvement in asset quality helps reduce the risk to the banking sector's solvency from problematic loans and frees up resources for more productive uses. The risk of unprovisioned NPLs to solvency, as shown by the ratio of NPLs net of impairments over capital, dropped to 20% at the end of 2018 from 31% a year earlier.

The improvement in asset quality has been supported by economic growth, which has resulted in higher employment, wages and corporate profit; recovering property prices; and corrective measures by banks, such as NPL sales, following a sector-wide asset quality review (AQR) and stress test in 2016. Thanks to strong investor interest, NPL sales, mostly by subsidiaries of large European banking groups, totalled around €530 million in the first half of 2018.

These developments set the stage for the European Central Bank's (ECB) upcoming comprehensive assessment of six Bulgarian banks as part of the country's bid to join the European Union's (EU) banking union (and ultimately enter the eurozone waiting room), which we believe will [help strengthen supervision](#) in the country. The results of this exercise, which includes an AQR and stress test, will be published in July 2019.

Despite the banking system's overall improvement, the performance of individual banks is mixed. The asset quality of domestically owned banks, which made up 22% of banking system assets as of September, lagged that of European bank subsidiaries, which accounted for 72% of system assets. Based on ECB data and definitions, domestic banks' NPL ratio was 12% as of June 2018, compared with 8% for the sector as a whole. The AQR and stress test in 2016 led to plans to strengthen the capital of three domestic banks, including that of [First Investment Bank AD](#) (B1 stable, b2²), the country's fourth-largest lender. First Investment Bank will also take part in this year's comprehensive assessment together with two smaller domestic banks, Central Cooperative Bank AD and Investbank AD. The other three banks under review are the country's largest and are subsidiaries of EU banks.

We expect the improvement in asset quality to continue through 2019, supported by positive economic momentum. We forecast that real GDP growth will remain at around 3.5% in 2019. In this context, Bulgarian banks increased lending in 2018, with loans to corporations growing by 5% and to households by 12%. The overall indebtedness of households in Bulgaria is among the lowest in the EU at around 23% of GDP. However, because some households may be more vulnerable than others, particularly to future interest rate rises, a prolonged period of rapid credit expansion has the potential to create renewed asset quality problems in the future. Similarly, growing lending to cyclical industries such as real estate and construction, may also lead to new NPL formation once the economic cycle turns. To that end, the BNB's governing council has decided to activate a countercyclical capital buffer of 0.5% that takes effect in October 2019.

Endnotes

1 We consider loans and advances to be loans to financial corporations, non-financial corporations and households. NPLs are defined as loans that are past due by more than 90 days and loans classified as "unlikely to pay" but are not past due or are past day fewer than 90 days.

2 The bank's ratings shown in this report are the bank's local currency deposit rating and Baseline Credit Assessment.

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IN THIS ISSUE

Strong economic conditions and new mortgage rules are credit positive for covered bonds in the Czech Republic, Hungary, Poland, Slovakia

Originally [published](#) on 10 September 2018

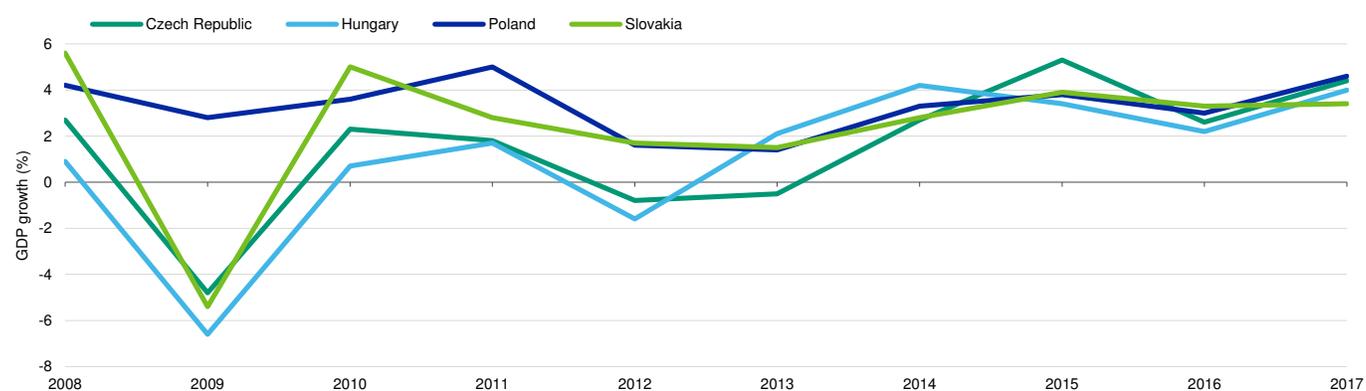
Summary

Supportive macroeconomic conditions and new mortgage market regulations are credit positive for covered bonds in Poland, Czech Republic, Slovakia and Hungary. Rising house prices in these countries pose credit risks for covered bonds, but risks will remain limited while economic conditions are supportive.

- » **Strong economic conditions and low interest rates create a supportive backdrop for borrowers.** Economic growth in Poland, Czech Republic, Slovakia and Hungary is strong, while interest rates are low, disposable income is growing and unemployment is declining. These factors support borrowers' ability to repay mortgage debt, which is credit positive for mortgage-backed covered bonds issued by banks from these countries.
- » **Regulatory measures curb mortgage market risks.** In addition to the supportive macroeconomic backdrop, new regulatory measures in Poland, Czech Republic, Slovakia and Hungary are positive for covered bonds, because they will help curb riskier mortgage lending and restrict leverage. The measures include, among other things, new or stricter restrictions on the amount of debt borrowers can take on relative to their income in Hungary, the Czech Republic and Slovakia, tighter maximum loan-to-value (LTV) ratio limits in Slovakia and proposed mortgage maturity limits in Poland.
- » **Rising house prices pose credit risks.** Over the past five years, house prices have increased significantly in the Czech Republic, Slovakia and Hungary, while prices have increased more moderately in Poland. Higher house prices mean that new mortgage borrowers are in some instances taking on larger amounts of debt and contributing less equity when purchasing property, which poses risks for covered bonds.

This report focuses on Poland, Czech Republic, Slovakia and Hungary because of the dynamic residential mortgage market developments in these countries in recent years and because an increasing number of banks that operate in these markets are considering using covered bonds as a funding tool for their growing mortgage loan portfolios.

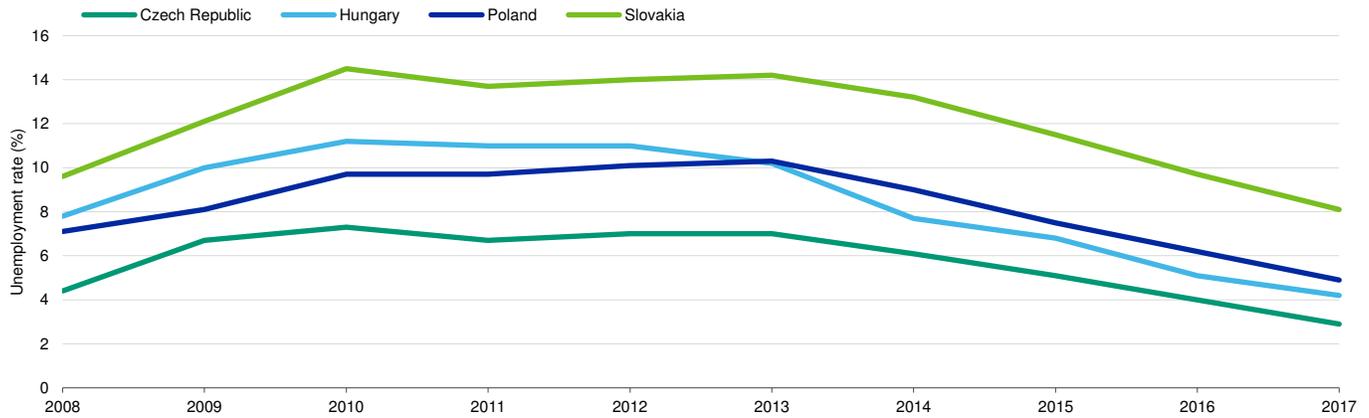
Exhibit 1
Economic growth is strong in Poland, Czech Republic, Slovakia and Hungary



Source: Eurostat

Exhibit 2

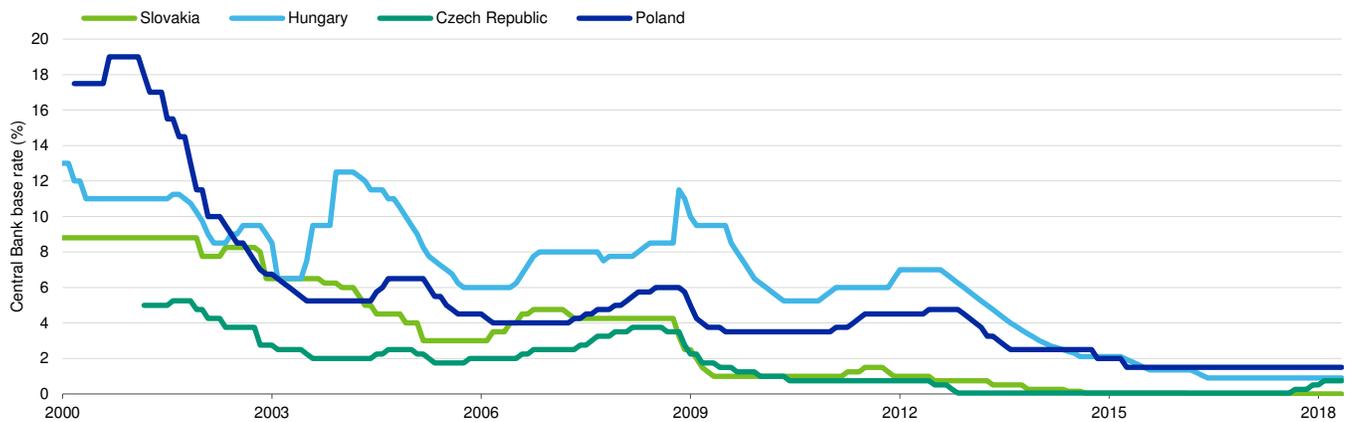
Unemployment is declining in Poland, Czech Republic, Slovakia and Hungary



Source: Eurostat

Exhibit 3

Central bank interest rates are low in Poland, Czech Republic, Slovakia and Hungary



Source: Eurostat

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IN THIS ISSUE

OTP Bank's acquisition in Moldova broadens its footprint and complements its domestic franchise, a credit positive

Originally [published](#) on 11 February 2019

On 6 February Hungary-based [OTP Bank NyRt](#) (OTP, Baa2 stable, ba1¹) announced that it agreed to acquire an 87.85% stake of Mobiasbanca – Groupe Societe Generale S.A. (SGMB), the Moldovan subsidiary of Societe Generale Group. Pending all regulatory approvals, Mobiasbanca would account for only around 1% of OTP's total assets, but the acquisition is credit positive because Mobiasbanca is Moldova's fourth-largest bank and will complement OTP's regional franchise and strategy to become a key player in the Central and Eastern European region.

With a market share of 13.3% based on assets, 69% of Mobiasbanca's lending is to local corporates. Deposits, the bank's main funding source, are broadly balanced between corporate and retail. Mobiasbanca's 4.6% net interest margin and its 2.9% return on assets as of year-end 2017 will complement OTP's strong profitability metrics.

Exhibit 1

OTP Bank's regional footprint

Bank size in terms of assets in each market, as of most recent data available



Sources: OTP Bank and Moody's Investors Service

OTP's performance is enhanced by its regional operations in nine regional markets, which will increase to 11 once two transactions are finalised. The returns in most of these markets, some of which are riskier than its domestic market, support OTP's better-than-domestic-peers' profitability. OTP's 2.2% return on assets as of September 2018 was significantly better than Hungarian banks' 1.5% return on assets as of June 2018. Similarly, OTP's 4.2% net interest margin (NIM) as of September 2018 was higher than its rated domestic peers' 1.9%-3.7% NIM. With reported Common Equity Tier 1 (CET1) capital of 16.4%² as of September 2018, OTP has significant buffer above its 12.0% regulatory minimum (excluding Pillar II buffers) to support growth organically or through acquisitions.

Following [a buying spree in late 2018](#) (see exhibit), Mobiasbanca is OTP's first acquisition this year. On 2 August 2018 the bank announced the acquisition of a 99.74% stake in Societe Generale Expressbank's Bulgarian subsidiary, making it the leading bank in Bulgaria, up from number two³; and an 88.89% stake in Banka Societe Generale Albania, making it the fifth-largest bank in Albania. In December 2018 OTP acquired 100% of Societe Generale Banka Serbia, which propelled it to the second-largest bank in the market with 14% market share in total assets, up from seventh largest.

Although the number of takeovers in a short time raises OTP's execution risk, the bank's strong track record having completed 16 acquisitions in the past 18 years mitigates the risk. Including transactions pending regulatory approval, OTP has entered 10 new markets outside Hungary since 2001, including Slovakia, Croatia, Russia and Ukraine, has bulked up its existing presence in Hungary and Bulgaria, and grown its assets sevenfold.

Endnotes

¹ The bank ratings shown in this report are OTP Bank's deposit rating and Baseline Credit Assessment.

² Including interim profit minus indicated dividend.

³ The acquisition was completed in January 2019 and the bank expects the integration process to be completed in 2020.

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IN THIS ISSUE

Getin Noble Bank and Idea Bank's planned merger is credit positive, but capitalisation remains a credit constraint

Originally [published](#) on 23 January 2019

On 17 January, Poland's [Getin Noble Bank S.A.](#) (GNB, B2 negative, caa1⁴) and Idea Bank (ID) announced an agreement to merge, subject to receiving regulatory approvals in third-quarter 2019. The merger, if implemented, will be credit positive for GNB because it will result in better operating efficiency starting in 2020-21 through cost reduction and cross-selling.

However, a more pronounced improvement in the merged bank's credit profile will require a sizable recapitalisation because both banks are thinly capitalised, loss-making and have more problem loans than most other Polish banks (see exhibit). The banks are in search of a financial investor willing to recapitalise the merged entity.

Exhibit 1

Both GNB and ID have weak financial profiles

Select key financial indicators as of the end of third-quarter 2018

	Getin Noble Bank S.A.	Idea Bank S.A.
Total Assets	54,995	23,731
Net Loans	41,207	17,296
Deposits	46,131	19,272
Equity	3,372	1,804
Total Capital ratio	12.10%	9.55%
Equity-to-Assets ratio	6.13%	7.60%
Net Income (annualised)	-56	-131
Cost-to-Income ratio	63.96%	71.06%
Nonperforming Loan (NPL) ratio	15.30%	10.20%
Loan Loss Reserve-to-NPL ratio	67%	56.18%

Note: NPL ratio for ID is based on 90+ days past due loans

Sources: *The banks and Moody's Investors Service*

Both GNB and ID are controlled by Polish businessman Leszek Czarnecki and the transaction will be settled by an exchange of shares. The transaction will be structured as a takeover, with ID acquiring all of GNB's assets and liabilities. The banks expect to benefit from synergies and reduce operating costs in 2019-21 by PLN370 million, and estimate integration costs at PLN220 million. Afterwards, they estimate the combined entity will generate annual cost savings of PLN180 million, or 13% of the two banks' combined operating costs. Cost reduction will be achieved by combining the two banks' headquarters and IT infrastructure, as well by optimising their branch network.

GNB ranks ninth in Poland by total assets and is predominantly a retail bank targeting both the mass sector and affluent customers in large cities. ID focuses on lending and leasing for individual entrepreneurs and small and midsize enterprises. The combined bank could leverage the customer bases and expertise of each bank and broaden its product offering. Upon completion of the merger, the bank will become the seventh largest in Poland by total assets, loans and deposits, according to the banks' investor presentation.

Given its profitability challenges, GNB has been admitted into a program of the Komisja Nadzoru Finansowego (Poland's financial supervision authority) to restore loss-making banks' long-term profitability, which temporarily exempts the bank from paying a special bank levy. If the merged bank is readmitted into this program, it would benefit from the bank levy exemption and be given sufficient time by regulators to strengthen its solvency.

According to our estimates, GNB's Tier 1 capital shortfall against the minimum required level of 11.85% in October 2018 was about 2.2 percentage points. The bank's main shareholder provided PLN100 million of equity to the bank in fourth-quarter 2018, on top of

PLN290 million injected earlier last year. Although these support measures have eased the capital pressure on GNB, both GNB's and ID's low capital levels will keep capital adequacy a key credit constraint for the merged bank without a sizable capital increase.

Endnotes

¹ The bank ratings shown in this report are the bank's domestic deposit rating and Baseline Credit Assessment.

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Statutární město Liberec (Česká republika): Aktualizace analýzy

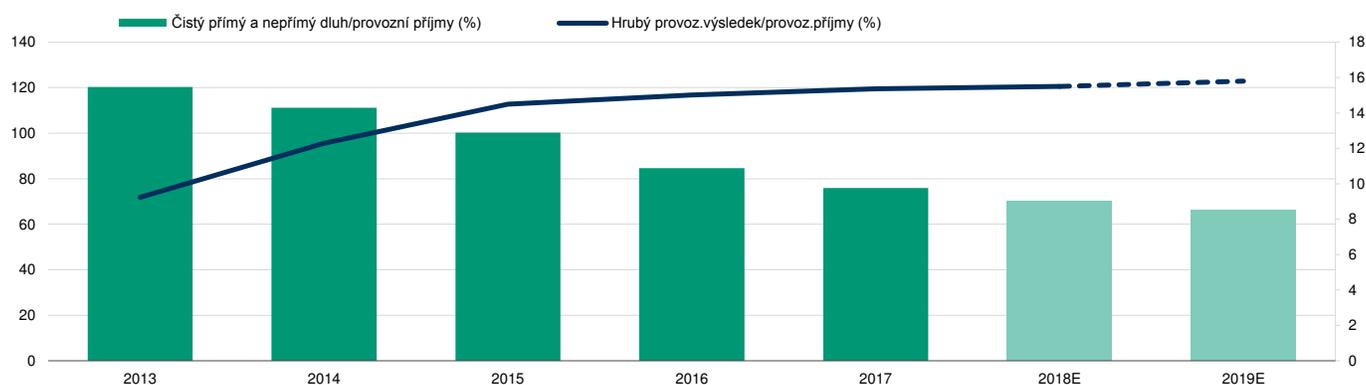
Původně publikováno 18.prosince 2018

Shrnutí

Kreditní profil statutárního města Liberce na úrovni Baa1 (mezinárodní rating) a A3.cz (národní rating) zohledňuje výraznou zadluženost města a s tím spojené vysoké nároky na obsluhu dluhu v porovnání s celorepublikovým průměrem. Dále pak střední pravděpodobnost, že vláda České republiky (A1 pozitivní) poskytne městu mimořádnou pomoc za účelem předejít akutnímu nedostatku likvidity. Kreditní profil zohledňuje také zlepšené rozpočtové hospodaření města, silnější likviditu, klesající zadluženost a plán města na snížení celkové zadluženosti pod 1 mld. Kč do roku 2025.

Graf 1

Klesající zadluženost města a stabilní provozní výsledky



Pozn: 2018-19 odhad Moody's

Zdroj: Město Liberec, Moody's Investors Service

Ratingový výhled

Výhled ratingu je pozitivní, zohledňující pozitivní výhled ratingu státních dluhopisů České republiky.

Co by mohlo rating – ZVÝŠIT

Výrazné posílení provozního hospodaření města, které by zvýšilo flexibilitu rozpočtu a kapacitu splácení dluhu, a snížení zadluženosti by mohlo mít pozitivní dopad na rating.

Co by mohlo rating – SNÍŽIT

Snížení provozních přebytků při současném zvýšení dluhové služby vlivem nárůstu zadluženosti by citelně zvýšilo rigiditu rozpočtu, vytvořilo tlak na financování kapitálových výdajů města a mělo by negativní dopad na rating.

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IN THIS ISSUE

Tax revenue to rise for both Zagreb and Belgrade, but to varying degrees, as economic growth accelerates, a credit positive

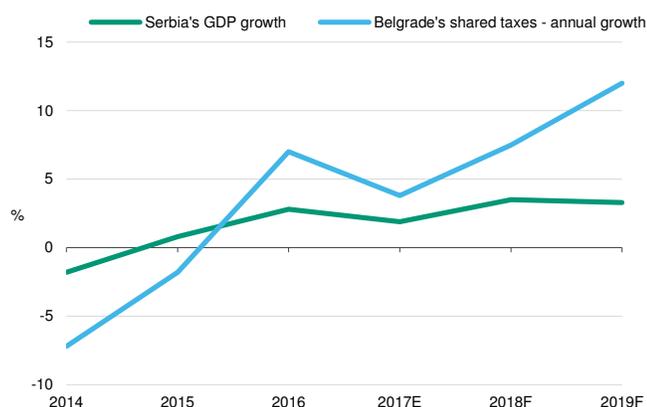
Originally [published](#) on 06 December 2018

The cities of [Zagreb \(Ba2 stable\)](#) and [Belgrade \(Ba3 stable\)](#) will improve their fiscal performance in 2018 and 2019 as economic growth in Croatia and Serbia bolsters tax revenue (although this revenue will be more volatile for Zagreb), a credit positive. Both cities will also generate healthy gross operating balances, boost their self-funding capacity and limit debt accumulation. However, pressure to provide additional funding to their transportation and utility companies constrains the credit profiles of both cities.

- » **Tax revenue set to rise significantly for Belgrade, more volatile for Zagreb.** The two cities will achieve higher tax revenue in 2018 and 2019 because of economic growth in their respective countries and increased receipts from shared taxes. The Croatian economy is likely to grow by 2.7% in 2018 and by 2.4% in 2019, while Serbia's economy is likely to grow by 3.5% in 2018 and 3.3% in 2019. This national economic growth will boost Zagreb's and Belgrade's shared tax revenue by 9% and 10%, respectively, over the same period.
- » **Zagreb's capital spending will be higher than Belgrade's.** Increased tax revenue will help Zagreb and Belgrade meet their long-term capital spending programs. Zagreb, in particular, is likely to benefit from European Union funding, which will enable it to bolster spending on infrastructure projects without putting its budgets under additional pressure.
- » **Although Belgrade has twice the debt of Zagreb, this trend is declining.** The direct debt burden of the cities varies from 21% of projected operating revenue in 2018 for Zagreb to 44% for Belgrade. The potential increase in capital spending may lead to only a slight increase in Zagreb's debt, with the ratio of direct debt to operating revenue not expected to exceed 25% by 2019. Belgrade's debt burden will likely stabilise at between 45%-50% of projected operating revenue by 2019.
- » **Belgrade has significantly better liquidity than Zagreb.** Belgrade has a much larger liquidity buffer than Zagreb, which reflects Belgrade's stronger operating margins. Its monthly cash reserves comfortably covers 2.7x of debt service requirements falling due in the next 12 months, while Zagreb's available cash covers about 26% of debt servicing costs over the same period.

Exhibit 1

Belgrade will see a significant increase in shared tax revenue

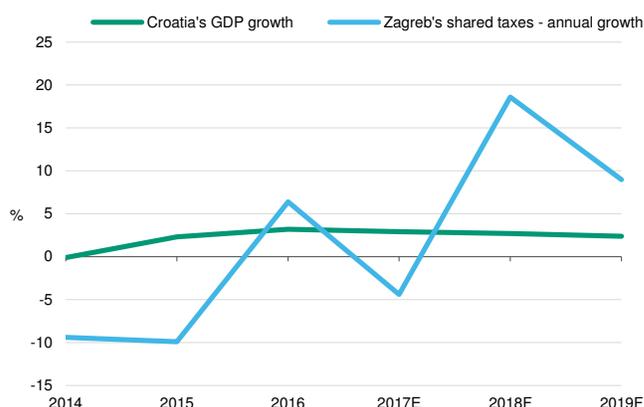


F — forecast

Source: City of Belgrade, Moody's Public Sector Europe

Exhibit 2

Zagreb's shared tax revenue growth is more volatile

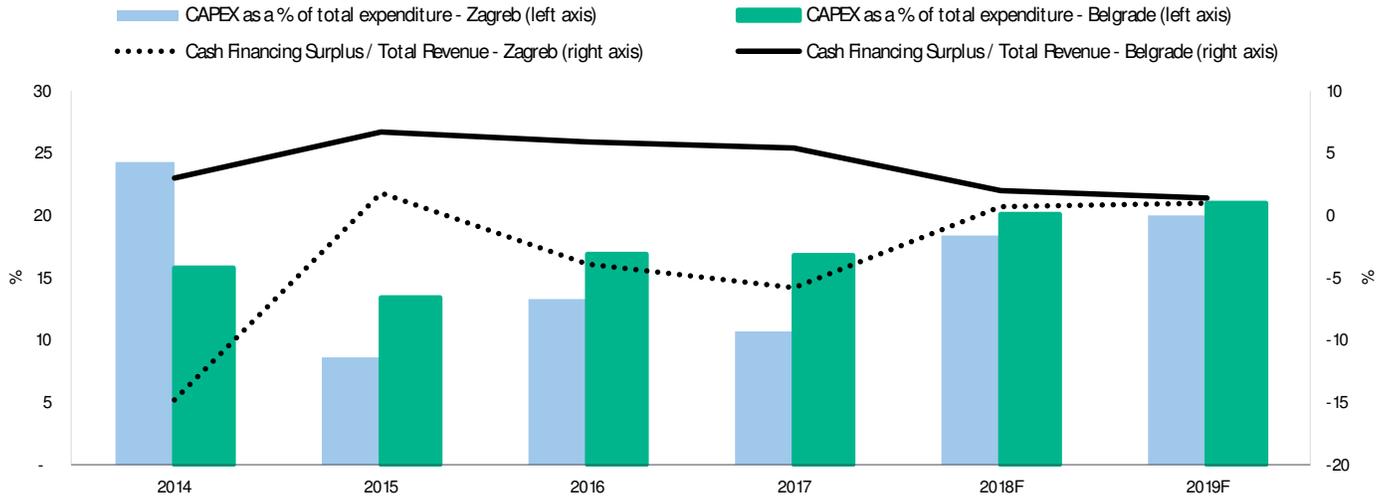


F — forecast

Source: City of Zagreb, Moody's Public Sector Europe

Exhibit 3

Increased capital spending will not weaken the cities' financial strength

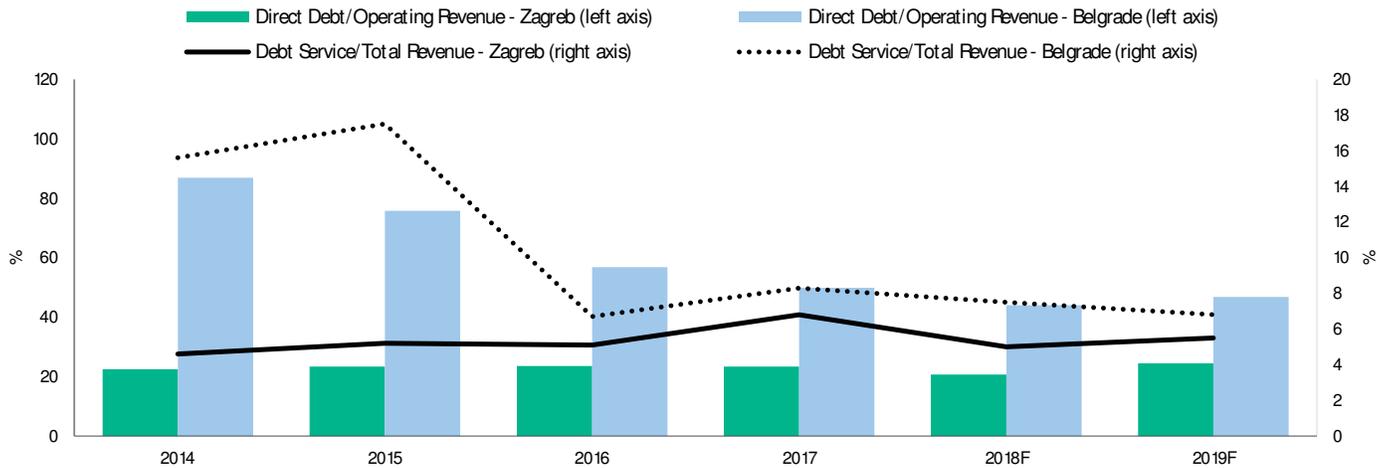


F — forecast

Source: City of Zagreb, City of Belgrade, Moody's Public Sector Europe

Exhibit 4

The debt levels of both cities will remain low to moderate



F — forecast

Source: City of Zagreb, City of Belgrade, Moody's Public Sector Europe

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