S&P Global Ratings

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Research Update:

Austria-Based Raiffeisen Bank International Upgraded To 'A-' On Stronger Financial Profile; Outlook Stable

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Overview

- In our view, the Raiffeisen Banking Group's (RBG's) strong consolidated funding and liquidity ratios are now also evident at the main operating entities.
- We acknowledge the group's stable performance, solid growth, and improving risk metrics.
- We believe the group's credit profile has strengthened by one notch and are therefore raising our long-term rating on the group's core subsidiary RBI to 'A-' from 'BBB+' and affirming our 'A-2' short-term rating.
- The outlook is stable because we expect RBG will maintain a cautious growth in higher risk countries over the next two years, alongside increasing intragroup cooperation that improves efficiency and strengthens the group's ability to combat emerging risks and the effects of economic slowdown.

Rating Action

On March 3, 2020, S&P Global ratings raised its long-term issuer credit ratings on Austria-based Raiffeisen Bank International AG (RBI), RBG group's core entity, to 'A-' from 'BBB+'. The outlook is stable. We affirmed our 'A-2' short-term issuer credit rating on the bank.

At the same time, we raised our issue ratings on RBI's subordinated instruments to 'BBB' from 'BBB-', and those on its additional tier 1 (AT1) capital notes to 'BB+' from 'BB'.

Rationale

The upgrade stems from our reappraisal of RBG's liquidity and our view that RBG is likely to maintain solid operating performance and a steady risk appetite, despite economic headwinds. Taken together, we see the group's creditworthiness as having improved relative to leading European and domestic peers. Accordingly, we have revised upward our assessment of the RBG group's stand-alone credit profile (SACP) to 'a-' from 'bbb+', leading us to raise our issuer credit ratings on RBG's core group member RBI and its debt by one notch.

In our view, the group's strong consolidated liquidity ratios are also being replicated at the main operating entities. Our opinion is based on the increased granularity of funding and liquidity disclosures for main operating entities. In our view, RBG's main network banks can manage potential liquidity stresses, which we consider a critical factor given the restrictions we see on intragroup liquidity transfers. In our view, group members' liquidity coverage would enable them to withstand a lack of access to wholesale funding for more than 12 months, as well as moderate reductions in customer deposits.

Moreover, we still consider that RBG benefits from an above-average funding profile compared with its domestic and international peers. This is owing to RBG's leading retail franchise in Austria and main foreign operating markets, underpinned by sizable surplus funding of the majority of local Raiffeisen banks. In addition, the group continues to demonstrate stable performance, solid growth, and improving risk metrics, amid good economic prospects for most of its markets and material work out efforts at RBI.

RBG continues to lag large peers in terms of agility, financial transparency, and efficiency. However, we expect the group to increasingly benefit from the RBI's strength and expertise in dealing with emerging risks and digital transformation. We view progress in these areas as crucial for RBG to maintain its competitive edge in the increasingly digital domestic market and adjust to customers' changing preferences and investors' expectations. We also acknowledge that cooperation among group members has gained momentum, which should help improve efficiency, still a material weakness for the group's local cooperatives and cooperative Landesbanks.

Nevertheless, RBG's profitability has been solid in recent years. The group reported €2 billion-€3 billion of annual pretax profits, or an 11%-14% return on average common equity, in 2017-2019 (2019 data is an estimate). In the near term, we think RBG's 2019 results will likely show an earnings peak, since impairment charges have bottomed out, and future revenue growth will remain constrained by ultra-low base rates in the eurozone. Notwithstanding continued growth opportunities in RBI's markets outside Austria, the group's profitability may therefore weaken slightly in 2020 and 2021. However, we anticipate that it will remain stable and sufficient to cover asset growth, meet the distribution expectations of RBI's minority shareholders, and facilitate a gradual capital buildup to offset the phase-out of certain capital instruments. As a result, we anticipate that the group's S&P Global Ratings' risk-adjusted capital (RAC) ratio, which was 9.3% at year-end 2018, will have increased in 2019 and likely be in the 9.5%-9.8% range through 2021. This projection assumes that growth in higher-risk countries remains contained.

RBG's consolidated liquidity metrics have long implied that liquidity is a distinct strength for the group. We estimate the ratio of net broad liquid assets to short-term customer deposits at around 25% as of year-end 2019. This ratio measures liquid asset coverage of deposits. We place particular reliance on this ratio because the bank has modest short-term wholesale funding relative to peers, comprising only 11% of the funding base. As a result, its coverage of short-term wholesale funding by broad liquid assets is routinely above 4x, compared with the 1x-2x ratios that we observe among many other large European banks.

The group's consolidated funding ratios are also impressive. At close to 80%, the loan-to-deposit ratio is likely to remain the lowest in RBG's peer group, and its S&P Global Ratings stable funding ratio, estimated at over 110% for year-end 2019, is likely to remain among the strongest. We expect that the group's mutual support mechanism and strong reputation will continue to boost customer confidence and stability of deposits in adverse conditions. The steadiness of the group's foreign deposit portfolio through the cycle was tested during periods of market turbulences over the past decade.

We continue to derive the ratings on RBI from our view that RBI is a core member of RBG. RBI remains integral to the group's identity and strategy, and we believe the rest of the group would support RBI under any foreseeable circumstances. While RBI continues to improve its resolvability, we do not see an accumulation of additional loss-absorbing capacity as a likely future rating driver. For our ratings, we would continue to assume the potential for substantial group support from RBG affiliates.

Outlook

Our outlook on RBI is stable because we assume the group will maintain its cautious approach to growth in higher-risk countries and its prudent risk appetite over the coming two years. We also expect that the cooperation among group members will gain pace over the medium term and that Austrian group members will increasingly benefit from RBI's leadership in addressing emerging risks such as digital challenges and ESG.

Upside scenario

While we consider an upgrade to be a remote scenario, we could raise our rating on RBI if RBG group's capitalization strengthened materially beyond our base case projections, with our RAC ratio sustainably higher than 10%. Notwithstanding the implications of a stronger balance sheet, an upgrade would also depend on the group's overall creditworthiness staying on par with that of 'A' rated peers, which are generally materially less exposed to higher-risk countries and have greater business agility.

Downside scenario

We could lower the rating if the group pursues an aggressive expansion strategy abroad, or is unable to improve efficiency of the domestic operations over the next two years and so better defend profitability in a cyclical downturn. Pronounced credit losses and weaker earnings in higher-risk regions, which could result in a material impact on capitalization, could also trigger a downgrade.

Ratings Score Snapshot

	To	**From**
Issuer Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2
SACP	a-	bbb+
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Above Average and Strong (+1)	Above Average and Adequate (0)
Support	(0)	(0)
ALAC Support	(0)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)

	To	From
Additional Factors	(0)	(0)

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded

	To	From
Raiffeisen Bank International AG		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2
Senior Unsecured	A-	BBB+
Subordinated	BBB	BBB-
Junior Subordinated	BB+	BB