Strategy and Finance Division

Investor Relations & DCM

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Transcript

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P R E S E N T A T I O N

Operator

Dear ladies and gentlemen, welcome to the First Quarter 2021 Conference Call of OTP Group. This conference will be recorded. (**Operator** Instructions)

May I now hand you over to László Bencsik, Chief Financial and Strategic Officer. László, the floor is yours.

László Bencsik - Chief Financial and Strategic Officer

Thank you. Good afternoon or good morning, depending where you are. Thank you very much for joining us today for the 2021 First Quarter OTP Group Interim Results Presentation Conference Call. I promised my colleagues to be relatively short in the overall presentation. As far as I understand, we have received some gentle feedback that I'm sometimes too ambitious. So I will focus on a couple of slides, maybe less than 10.

Just to highlight some messages, which we consider particularly important. The presentation what we use is on the website. It was uploaded at 1:00 p.m. Central European Time. So hopefully, you have been able to look at it. But we are also showing it on the screen while I'm talking.

Let's start on page 4, maybe, which shows the major P&L lines for the group. There are some remarks, which are worth making. Obviously, we had a good quarter, almost as good as the third quarter last year. That was driven by risk cost primarily, obviously. If you look at the last 5 quarters, the risk cost dynamics differed a lot. The first quarter of last year was quite high with HUF 92 billion. Then it went somewhat lower, close to HUF 40 billion in the second quarter. And then the third quarter was really low. Therefore, we actually achieved last year third quarter historic high profit level. And in last quarter last year, we also provisioned more.

All this provisioning last year were related to forward-looking expectations, IFRS 9 methodology, not actual credit losses, but we identified more like anticipations of potential future losses, which so far have not really manifested. And therefore, in the first quarter, we didn't provision much, because there was no need. So if we look at the 90 days plus due developments or the Stage 3 ratio or the 90 days past due ratios, they improved and did not deteriorate. There was no reason to further provision.

Putting aside the risk cost part of the story, I think the most important number here is the year-on-year adjusted operating profit growth rate. And there are a couple of adjustments, which we made here, first one for FX exchange rates. And then you probably remember that last year we divested Slovakia during the fourth quarter. So that introduces some noise if you want to compare year-on-year quarters. Plus we made a kind of classification methodology change in Hungary relating to operating expenses. There was HUF 4.4 billion equivalent of local taxes, which we pay in Hungary quarterly, roughly this amount, and it's around HUF 16 - 17 billion per year, so it's quite a big amount. It used to be booked within operational expenses. It's clearly a tax based on revenues, not on profit, but revenue tax. It's paid on local municipality level. We have changed auditors we have now Ernst & Young, so the figures that you see here are audited figures for Hungary, and for the group, we have an audit review, so those are reviewed numbers by the new auditor, Ernst & Young. They drew our attention to the fact that other banks in Hungary typically account for this local tax as corporate tax. It's very Hungarian-specific, so we don't have that in any other country. Therefore, we reclassified it.

If we make these 2 adjustments, then we end up with a 13% operating profit growth, without one-offs year-on-year using the first quarter as a benchmark. I think this is quite a good result, given the difficulties that we have all had during last year, despite the COVID situation and the substantial economic contraction in some of the countries where we operate. All in all, we managed to increase our operating results by more than 10%. It was 13%. I think this is quite remarkable, and we are quite happy to see it and especially, because this was primarily driven by revenue growth.

Revenues grew 8%. Each revenue line, including net interest income and fees, grew, which is also remarkable, given the net interest margin compression and the drop in business activity and transaction volumes during the COVID-19 situation, which had a negative impact on volumes.

The next slide I will talk a little bit more about is Page 8 about margins. We have had this long story of margin compression. For many years now, we've experienced quarter-on-quarter, year-on-year compression in margins. When we talked about our expectations regarding this year net interest margin, we said that it may continue to decline. Indeed, if you look at year-on-year expectations, last year the annual net interest margin was 3.61%. If we compare to this number, it is very likely that the annual number for this year will be lower.

However, what happened during the first quarter compared to the fourth quarter last year was that the margin actually increased, not by 5, but by 4 basis points. I mean these are rounding problems here, but basically 4 basis points, primarily driven by margin increase in Hungary, which was then driven by the end of this temporarily lower APR of newly disbursed consumer loans last year, they jumped up to their kind of market levels; and also the moratorium-related negative adjustments, which we made last year, gradually come back to NII over the course of the duration of the portfolio. So that was also lifting up the margin.

The question is whether this situation will continue over the course of the year or not. My short answer would be that we don't know exactly. There are many factors at work here. If all the factors account for our benefit, then we can imagine a scenario where there will not be further quarterly decline in margin. But again, this would be a kind of lucky best scenario. Due to the very intense price competition, it is quite possible that we will see further slight decrease in margins.

Let's move to volumes, Page 9, quarterly loan volume dynamics. Given that we had, in the first quarter, the end of the second wave and the first half of the third wave of the virus in most of the countries where we operate, so operationally and in terms of COVID-related restrictions and the negative ramifications on the economy, this was still a very much negatively affected period. Despite all these headwinds, we managed to grow the portfolio 2% just in one quarter.

Hungary was particularly strong with 3%. And within Hungary, consumer loans, 7%. Part of this was this subsidized baby loan. But if you just look at market-based cash loans, their volumes grew 4.8%, so almost 5% quarterly growth in market-based cash loans in Hungary, which is quite a good number. And housing loan growth wasn't astronomical, but in fact, if we look at new loan applications, then year-on-year, if you compare this quarter with the first quarter last year, then the increase was 35% in terms of housing loan applications by clients.

Russia remained negative, but this is seasonal. So in previous years without COVID-19, we had seen similar low growth in the first quarter, even in the second quarter. This is the country where we expect the biggest recovery, the strongest adjustment in the trajectory of portfolio growth. We may remember that last year, Russian volumes declined by 11%. If all goes according to expectations, then the second half of this year we should see a very robust growth in our Russian volumes, maybe more than 20%.

In other countries we expect marginal improvement and actually acceleration of lending activity. Some countries might be quite robust, which were not so strong so far due to the improving economic conditions and the petering out of the COVID-related restructurings. So, we had 2% loan growth.

If you go to deposit growth to Page 11, it was actually 3% on a quarterly basis. And nominally, it was even much bigger. I mean HUF 250 billion more, or almost HUF 300 billion more deposit growth than the loan growth. So this last quarter was typical, in a sense, of the last 5 quarters that deposit growth nominally was much stronger than loan growth. Therefore, excess liquidity further increased. This we hope to turn around in the second half of this year. And hopefully, second half, we are going to see larger nominal loan growth than deposit growth. Then we slowly again start to improve and build back the efficiency of our balance sheet.

Maybe a few words about net fee income, Page 13. Here what you can see is that, year-on-year, we had 5% FX-adjusted net fee income growth without the divested OBS, the Slovakian bank. Here what you see is a very mixed picture. In some countries, Hungary, Bulgaria, we're growing quite fast. Then you can see some negative numbers here. I think the overall 5% is not bad, but it could have been better if some countries were not kind of laggards having actually negative growth.

So, we have Croatia and Montenegro with minus 3% and minus 17%. Obviously, in these 2 countries, they have a very large exposure to tourism, and typically, transactional revenues are related to tourism, tourist industries, as tourists are spending money, ATM withdrawals, etc. This did not happen during the course of basically last year, and that had an impact on the first quarter as well. In these 2 countries, we believe it's quite reasonable to expect improvement once the COVID situation is over.

In Serbia, it was just a technical reclassification, which happened in the first quarter this year. So without that technical change, it was actually positive. Then we have Russia where, again, the year-on-year change was the biggest negative nominally. That is purely due to the new loan generation, which is still lower than last year. We typically generate fee income in Russia when we sell new consumer loans and we also sell insurance products and we get the commission. That's a large part of our revenue stream in Russia. As soon as volume growth turns around here and starts to increase, again, we believe it's reasonable to expect fee income to grow as well.

All in all, I think 5% growth in this environment year-on-year is not bad, but it could have been better if these countries were not underperforming. Once they do, they will come back to normal performance after the COVID-19 restrictions are over, then hopefully we will see even higher growth rates.

Maybe a few words about operating cost, Page 15. Overall, if we do adjustments for the divestment of Slovakia, FX and this kind of HUF 4.4 billion I mentioned, the reclassification of local taxes, then the year-on-year growth of first quarter was 3%, which is, I think, quite okay. Here, as well, you can see some negative numbers. We have actually managed to decrease the cost base primarily in Bulgaria, Serbia, Montenegro and Croatia. These are the 4 countries where we have done mergers during the last 3-4 years. It started with Croatia and then Serbia and then Bulgaria and then Montenegro. The last one, the latest happened in Serbia just over the last weekend. It was very successful. All of these were on time, on budget.

As you can see, in each case, we still have some cost savings manifested. It's Serbia where we should see further cost synergies to manifest due to the last acquisition what we did. The last line where you see here this growth in the first quarter levels just related to a consolidation of an entity, which used to be out of the consolidation, which we acquired last year.

Maybe Page 19. I mentioned the Serbian merger, which was done successfully on time, on budget. In fact, this is the third merger which we finished during the COVID situation. Just to remind you, last year, end of April, we finalized the merger in Bulgaria just in the middle of the COVID lockdowns, when we had very serious lockdowns. And back last year, in December, we did the Montenegrin merger. And now we finished the merger in Serbia. With this, we completed the integration and merger process of the second wave, this last bunch of acquisitions, what we have made, the SocGen assets plus the NBG assets in Serbia. So now all the merger processes are over.

With this last action, we created a bank in Serbia, which has the largest loan volumes, so this is the largest bank by loan volumes in terms of market share. By assets, we are No. 2, but actually deposits are not making huge returns. So we are quite happy to have a leading position in lending volumes.

The good thing is that, even during this merger process, we managed to substantially improve and increase our volumes, as you can see on this chart and also our market shares in Serbia. So despite being busy with the merger during this period, we managed to increase our market shares as well, which is, I mean, a huge credit to all our colleagues who were on this in Serbia and brought together this fantastic performance.

Maybe next slide, Page 20, the loan book. Again, not much happened in terms of Stage migration or credit quality change. Therefore we didn't provision much, as you know. In fact, the Stage 2 ratio remained stable, and the provisioning levels also remained more or less stable. As you can see on this chart, we believe that we are very conservatively provisioned in terms of Stage 1 and Stage 2 loans, the performing loans compared to some other banking groups. We believe that there's a lot of reserve here in case our optimism related to the future is manifesting, which is quite likely by the way.

Finally, maybe a few words about the macro situation and expectations regarding to the macro situation, Page 24. Across the countries where we operate, we expect a very robust economic recovery once the COVID-19 situation is over. We expect this to be over by the end of the second quarter. Maybe some countries will come out faster and some countries somewhat slower. But by the third quarter, we expect all these countries to be out of the negative effects of the COVID-related restrictions. Therefore, we expect a very robust economic growth period to start with high consumption, high labor demand, increasing wage inflation, increasing inflation in general. In this environment, we expect new investments to start and new capacities to be built, therefore, a strong investment cycle to start.

That is again, true for pretty much all the countries where we operate. Especially if we talk about the timing, it is maybe worth noting that Hungary is the most advanced in terms of the vaccinations in Europe. We have vaccinated more than 40%. It's like 43% of the population in Hungary has received the first jab. So Hungary is quite in the forefront of vaccination. We pretty soon should reach a level where this herd immunity kicks in, and then we can safely operate without strong restrictions.

In a nutshell, it was what I intended to present. But I'm very sure that you have a lot of questions, which we will have time to answer. So please, I'd like to ask my colleague to open this floor for questions.

Q U E S T I O N S A N D A N S W E R S

Operator

(**Operator** Instructions)

The first question is from Andrzej Nowaczek, HSBC.

Andrzej Nowaczek - HSBC, Research Division - Analyst

I have a couple of questions. First, can you talk a bit about the Hungarian loan moratorium? The participation rate seems to have dropped somewhat, but that's probably because of strong loan growth, right? So how do you gauge what will happen after this ends in June, July? What are the metrics to look at here?

László Bencsik - Chief Financial and Strategic Officer

Indeed, the number dropped, so yes, 32% of the gross loans. As you rightly pointed out, typically, this number moves because of the overall portfolio, so the denominator increases. The experience from other countries where the participation rate was much less than in Hungary, but where the moratorium ended already last year during the COVID-19 situation, so not in this dynamic economy growth environment, but we expect to be there by July, in the middle of the COVID-19 situation. In Bulgaria, the Stage 3 ratio out of those clients who exited the moratorium is less than 3%. In Romania, it's 5%. We only see higher numbers in Croatia and in Montenegro, which were hit the hardest by the whole COVID-19 situation due to their large exposure to the tourism industry. So in these countries, it's like 8-9%. In these countries, the participation ratio was much smaller, between 5% to 10%. Out of this 5% to 10% when the moratoria ended, between 3% to 8-9% actually ended up in Stage 3.

If you assume that in these countries where the participation ratio was much smaller, and the more exposed or higher credit risk clients entered the moratorium in the first place, and they ended up with these ratios. Well, I think it's fair to assume that in Hungary, we should not see higher numbers than in Bulgaria or Romania, 3% to 5%, with moratoriums which were between 6% and 10% of total portfolios.

I can't imagine that this numbers will be higher in Hungary, because in Hungary we had, first of all, a much bigger participation rate and the timing of the moratorium ending will be in the middle of a huge rebound in economic activity. Therefore, the actual default rate of the moratorium volumes in Hungary should be kind of low single digit, based on formal logic and the experience what we have in other countries where the moratorium already ended.

Andrzej Nowaczek - HSBC, Research Division - Analyst

And then in that context and given the low amount of loan loss provisions in Q1, why didn't you revise your cost of risk guidance?

László Bencsik - Chief Financial and Strategic Officer

Because we believe that the cost of risk this year should be less than last year.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Materially less presumably?

László Bencsik - Chief Financial and Strategic Officer

I think that's fair, correct to assume, yes.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Okay. And then quickly just one other thing. I noticed the number of employees in Hungary is rising again. What is it due to? And what is the outlook for salary increases and bonuses in Hungary and across the platform?

László Bencsik - Chief Financial and Strategic Officer

It's the increasing economic activity. I mean we are extremely busy. Maybe we can share these 2 slides for Hungary, one on corporate and one on retail. Corporate lending, just in one quarter, first quarter this year, micro and small company loans increased 14% due to this Funding for Growth Go! programme, where we basically issued almost HUF 600 billion loans. These are smaller loans with huge operational work.

If we go back to the retail slide on page 16, we accepted 35% more mortgage loan applications in the first quarter this year than first quarter last year. That's a massive growth of activity. So that's more or less the reason behind the FTE growth or the fact that it's not getting less.

In terms of wage dynamics, I think it's fair to expect, again, high, maybe even double-digit level of wage inflation coming back quite soon. Even today, the labor market is relatively tight, unemployment levels are low. Once the heat will be on, in the second half of the year, I expect general inflation to go up, but wage inflation will be, for sure, higher and stronger than the CPI, which is going to generate pressure on the Hungarian cost efficiency.

If you look at our group level cost-to-income ratio, in the first quarter it was 51.2%. Obviously, if you want to compare it to previous quarters, then you have to adjust back with this HUF 4.4 billion local taxes. If you make that adjustment, then on group level, the cost-to-income ratio was 52.7%. The Hungarian cost-to-income ratio was 50.5%-in the first quarter. These are not bad numbers, in such a low rate environment and lower net revenue margin environment.

Operator

The next question is from Anna Marshall, Goldman Sachs.

Anna V. Marshall - Goldman Sachs Group, Inc., Research Division - Equity Analyst

A couple of questions from me, please. Firstly, on the outlook, I have noticed that basically you've removed the outlook slide from the presentation. And I appreciate that you have already commented on kind of some elements like cost of risk or margin trajectory. But generally, is there anything else you can comment on the other elements of the previous outlook? Do you expect kind of more positive, less positive dynamics there? So this is my first question.

And then the second one on M&A. So you said that you've completed the merger processes that you initiated before. How does the picture look like going forward? And in particular, can you comment on the kind of attractiveness of some of the kind of markets that have been mentioned in the press?

László Bencsik - Chief Financial and Strategic Officer

In terms of outlook, we did not put the slide, because we haven't changed the outlook. We made 5 statements. First of all, that the ROE may be higher this year than last year. Based on the first quarter I think it's a very valid statement that it may be like this. In the first quarter, we made the adjusted ROE was more than 18% and the accounting ROE was almost 15%. And you probably remember that we accounted the entire bank tax for the whole year in Hungary. So therefore, typically the accounting result of the group is lower in the first quarter.

Then we said that we expect around similar level of loan growth like last year. Last year, we had 9%. Again, here, I think the first quarter result of 2% is actually quite positive and quite supporting to believe that, indeed, it will be at least as much as last year, given this narrative, what we have that we expect the loan growth to materially accelerate second half of this year, especially in places like Russia.

Net interest margin, again, the outlook was that it may continue to decline. And I said today that we still expect it to decline on a year-on-year basis. Quarter-on-quarter, it's another story. There are many factors here. If everything goes extremely well, then it may actually not decrease further on a quarterly basis.

Risk costs, as I said, we said that we expected this year to be lower than last year. We continue to expect that.

Then we said that the cost-to-asset ratio may be lower this year than last year. Last year, we had 2.9%. The first quarter was 2.63%. Again, if we make this adjustment with the local taxes, then it's 2.71%. I think it seems possible that we can get to this level.

So that's the outlook, no change basically, no change in general. The first quarter results made these statements what we made when we presented the last year results even more probable, I think.

The second question was related to M&As. Indeed, we have completed the mergers. We digested the last wave of acquisitions, and now they are firmly rooted in the group structure and the organization and churning out efficiently returns. So we're very happy. It's not just the IT mergers and the system changes and the processes and organization, but I think also culturally, we managed to integrate these entities in a positive way, in a way that OTP itself improved and reached a higher level by combining our strengths with the strengths of other organizations and actually creating something more than the 2 previous units.

I think we have gained a lot also in terms of knowledge, culture, approach, diversity, which are extremely important for future success. Indeed, we feel quite ready to continue and do further acquisitions and do the very difficult job of integrating and merging further banks into the group. But obviously our intention alone is not enough, so we need assets, good assets for sale, and we need sellers who agree with our assessment of the values of assets. And we are working on these stories. As always, we refrain from commenting press releases or anything appearing in the press. So, excuse me, I won't make specific comments on any of these. Other than that, we are working hard on various opportunities as we speak.

Operator

The next question is from attendees joined via phone. (**Operator** Instructions)

Máté Nemes - UBS Investment Bank, Research Division

This is Máté Nemes from UBS. I have 2 questions, firstly on net interest margin. I just like to refer back to your comments on competitive pressure in some markets on net interest margin. I'm just wondering if you could give us a bit more color on which countries, and perhaps which markets do you see the most pressure that could influence really group NIM? And this in the context of obviously some positive developments on monetary policy rates in some jurisdictions like Ukraine and Russia. That's the first question.

And the second question is on Hungary, mortgage lending specifically. On Slide 16, you're showing that OTP's market share in mortgage loan contractual amounts declined slightly in 1Q. And it seems like this is really the first time for a long while. I'm just wondering if you could kind of comment on the reasons for that. Are you seeing any, let's say, irrational behavior in the market from some of your competitors perhaps to pick up volume? Or are there any specific reasons for that?

László Bencsik - Chief Financial and Strategic Officer

Price competition in different countries. Clearly, the most competitive environment, from our perspective, are the ones which are either in the Eurozone or quasi-Eurozone countries or kind of joining the Eurozone, especially Slovenia. I mean, as you can see on this slide, this is the lowest net interest margin country.

Slovenian corporate loan pricing, from our perspective, is really getting to a territory which we find hard to understand, so to say, why our competitors are going to those levels. Also Bulgaria continued to experience this margin pressure and very high competition. Bulgaria last year joined ERM II, and they're moving closer and closer to joining the Eurozone. I think our Eurozone-based competitors already consider it Eurozone and Eurozone risk. So we see quite a margin decline there as well.

Now on the other side, just as you mentioned, in Russia and Ukraine, where the rate environment started to increase and where we have rate hikes and inflation pressure, it seems that the margin environment is somewhat more accommodating. I think these are the 2 kind of edges of the spectrum: on one hand, Russia and Ukraine, which are now somewhat better from a margin perspective; and then Bulgaria and Slovenia, on the other hand, which are fiercely competitive and declining.

The mortgage market share -- can we go to that slide on Hungary, page 16? I would not try to read into this any kind of tremendously meaningful story. It's still quite high. And disbursement, in our case, is lower in the first quarter. This is partially due to the fact that November, December was weak due to the restrictive measures regarding the second wave of the COVID-19 situation. But then the first quarter was extremely active in terms of new applications, as you can see here, +35%.

What happened that the new subsidized structures kicked in and also the VAT decreased for new residential developments, and this new subsidy type for refurbishments. I think what happened was that our clients waited and they postponed their real estate purchasing and mortgage applications from the fourth quarter last year when these new measures were already known, but not yet introduced. And they made the applications in the first quarter, benefiting more from the subsidized structures.

In general, whenever we talk about subsidized structures, we typically have a much higher market share – a good proxy to that is Page 17, you see our market share from the most prominent subsidized structure at the moment. As you can see, we have above 40% market share from baby loans, much higher than our overall market share. So maybe this somewhat explains the end of first quarter somewhat lower volume market share. But it doesn't mean that we're losing ground at all.

(**Operator** Instructions)

Olga Veselova - BofA Securities, Research Division - Equity Banking Analyst

This is Olga Veselova from Bank of America. My first question is about potential provision releases. You say that you have provisioned quite a bit last year. You didn't see major reasons to add provisioning now. Do you think there can be a situation for potential releases in the next quarters? And if yes, then in which regions or segments you anticipate to see that? This is my first question.

The second question is about the fiscal stimulus in Hungary. Earlier this year, you mentioned there was a new program launched in Hungary, lending for renovation. How substantial this program currently is? Or is it still small? Is it a nice addition to the programs in which are already in operation? And do you think this will evolve into something material over time? This is my second question.

And my third question is about your cost outlook. You mentioned you anticipate higher CPI and also some wage inflation in the regions over time. So can you possibly quantify your expected cost growth this year, maybe even next year or at least trajectory? Do you think it will be mid-single digits, higher, lower?

László Bencsik - Chief Financial and Strategic Officer

Okay. I mean it may happen that we will release provisions. I think it's maybe too early to talk about this. First, we should see what we expect to happen right at the end of the COVID-related restrictions. So if we are right, then, for instance, in Hungary, we expect no further restrictions starting from June. And hopefully, the tourist season will be very strong in the countries, which were hit hard last year like Croatia and Montenegro. We already know that they lost the pre-season. April, May, even June may not be too strong. But July, August, and hopefully, the after-season and the turnout will be strong in these countries.

If all goes very well and there's no further wave of the virus, a new version of the virus and so on and so on, then I think it can happen that we will end up releasing provisions. But what you see today as provision levels, they reflect our best judgment and based on the models and our discussions with the auditors. We always tend to be conservative and, we are not going to give this up. We believe that's the right approach to be always on the conservative side as much as possible, given the different accounting and tax regulations. But within this context, if all goes well, yes, I mean, there's a potential. But it's too early to count on that or kind of forecast it for sure.

The lending for construction just started, so this is quite new. This is one of the reasons why I think applications were lower in the fourth quarter. Therefore, new loan generation was somewhat less in the first quarter. But applications jumped up in the first quarter, because people were waiting for that. It is a meaningful volume - the new volumes we expect are around HUF 50 billion for this year, but we will see. But it's important.

Cost situation, in general, cost growth. First of all, we have this 3% year-on-year growth with all the adjustments in an environment, which is somewhat moderate in terms of cost development actually, because wage inflation was not strong during this period. I would be surprised to see lower levels of cost growth than this. Certainly, if anything, cost trajectory should be somewhat higher than what we saw last year.

Having said that, we are not in a cost-cutting mode. This is really a very active growing period, what we expect to happen, which in itself, how much costs grow, is not a good proxy. It's more like cost-to-asset or cost-to-income ratios which matter. In terms of cost-to-asset ratio, which is independent of the margin development, and therefore, we just started to use that more. We said that we expected improvement year-on-year. Indeed, if this strong economic activity kicks in, and hopefully, revenue growth would be strong, then I think the cost efficiency ratio should, if anything, improve despite whatever cost growth we are going to see. In general, we are going to have a higher inflation environment, that's what we believe. And that should have an impact on the revenue side as well.

(**Operator** Instructions)

Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst

This is Robert Brzoza from PKO BP Securities. I have the following questions. Number one, you are mentioning in your report that the first-time consolidation of the other subsidiaries in Hungary, taken together with the improvement in the equity consolidated entities, added about HUF 4 billion to the quarterly net profit. And my question is should we think of it as a one-off or a new additional run rate contribution to the net profit of the group?

Question number two is about cost of risk. You're commenting that the first quarter recoveries at OTP Factoring were lagging previous quarters because of the upward revaluation of Factoring claims, which was performed in the 4Q '20. Essentially, you recognized some future expected recoveries already in the 4Q. So the question being, is the new level of the recoveries seen at OTP Core perhaps plus this HUF 1 billion reclass into other income, should it be sought as a new run rate compared to the HUF 9 billion of recoveries generated in the third and the fourth quarter of '20?

And question number three, on the technical impact, the HUF 2.5 billion attributed to the loan repayment moratorium on the NII, my question is, what will happen after the moratoria expire? What would be the potential impact on the NII?

And finally, question number four, I was reading that there is a potential for the government to cut, by 2 percentage points, the employers' contribution -- share of the social contribution in Hungary. Would you expect that to happen? And if so, when? And would it help you to keep the cost -- the labor cost in Hungary growth at a more maybe lower level than you discussed during the confcall? Or you haven't included this in your guidance yet?

László Bencsik - Chief Financial and Strategic Officer

Starting from the first one, there were 2 very independent events what happened. We included into the scope of consolidation a new entity. It's an agro business, which we acquired last year. And it has an impact on other income, because it's total revenues classified as other income. So there was a close to HUF 2 billion positive effect on the other income side, and there was roughly HUF 2 billion contribution to the cost. The overall profit was relatively small in the first quarter coming from this entity. But these 2 legs, the revenue and cost legs, will stay with us. So that's not structural.

Now the other one, which we said was the result of entities, which were equity consolidated. These are basically revaluations coming from our private equity-type investments. We have investments funds. We have a digital fund. We have a VC fund. We have a private equity fund. And they do generate quite good returns. And there was just kind of appreciation of the value of one of these funds and the assets in the funds. So that was more of a one-off. It's not going to happen every quarter, but structurally, we expect them to contribute substantially. I mean, they have actually quite good returns. So from time to time, we expect from them meaningful profit contributions.

So in a way, this part is one-off in a sense that it's not going to be repeated every quarter, but it's not one-off in a sense that we expect further gains coming from these portfolios in the future, but maybe not regularly or quarterly.

Factoring recoveries and the one-off appreciation we made last year. It has some effect, but not a big one. And there was a structural change as well. We reclassified HUF 1 billion to other income from risk costs. But we still expect quite a robust recovery coming from the Factoring volumes. The first quarter was better than what we planned. And these value adjustments, which we made last year, don't have a big material impact on the recoveries that we are going to book this year. Indeed, we made this one-off adjustment. But the impact for this year recoveries, accounting-wise, is not that big. That means that we may do, in the future, further adjustments in the value of these volumes in Factoring.

Then, this NII increase due to the moratorium. When the moratorium was announced at the end of the fourth quarter, we accounted for this one-off net present value loss. This net present value loss is spread over the duration of these loans, so this one-off negative is going to be less and less, and we book positive number into the NII to compensate for that, and that should be there for the duration of the loan. This has been already done for this expansion of the moratorium. There's no further impact expected actually. You won't see much in NII when the moratorium ends.

The social contribution percentage, it has decreased. Now this is the fourth year, I think, that it decreases. It has decreased in steps over the last couple of years. And yes, there's some further decrease. At the moment, it's

17.5%. I think it came down from something like 20%. So it has already came down quite materially. And the further decreases, I'm afraid, may not be quite strong. So pretty much the current level, I think, overall is something to expect, especially now that if you look at the budget deficit, it sort of exploded last year and also this year. Even for next year, the newly accepted budget includes 6% budget deficit.

But it's a special period from the EU perspective that temporarily, they allow member states to run much higher deficit than the 3% expected. I think next year may be the last one where they accept that. So some fiscal adjustments will need to be done after next year. Therefore, I don't think there will be a lot of room to further decrease social contributions.

Operator

The next question is from Simon Nellis, Citigroup.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Actually my first question would be on Stage 2 loans. I see that they've gone down for most divisions, but there was a big jump at Merkantil. If you could talk about Stage 2 loan developments generally and Merkantil in particular. Maybe I'll go one-by-one. It makes it easier maybe for you.

László Bencsik - Chief Financial and Strategic Officer

Merkantil, yes, I mean, the new requirements by the Central Bank, we applied for OTP Core at the year-end, but not in Merkantil, so in Merkantil we applied the requirements of the Central Bank only at the end of the first quarter.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

So it's kind of a catch-up of what you did.

László Bencsik - Chief Financial and Strategic Officer

That was the real expectation. In the rest of the Hungarian book actually we did it earlier than we were supposed. So that's the rationale behind the Merkantil increase. The fact that the OTP Core, so the other non-Merkantil Hungarian loan book Stage 2 decrease is also because of the denominator is growing, right? So we have a growing Stage 1 portfolio.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Okay. And then why generally elsewhere have Stage 2 loans been going down? It's not migration to Stage 3. So is it just improving ratings? Or what's happening?

László Bencsik - Chief Financial and Strategic Officer

I'm looking at the numbers. In Romania, there is some decrease. But there also, the Stage 3 ratio decreased. Then there's a small increase in Serbia, 30 basis points in Stage 2. It's Croatia where we had a decrease. Croatia was the other country where we had a Stage 2 decrease. And it's due to the fact that, you'd probably remember, there was an earthquake, right, in the first quarter in in part of Croatia. It was actually quite severe in certain parts of Croatia. We classified loans from that region to Stage 2 year-end, just to be on the safe side because of the impacts of the earthquake.

But really there wasn't much problem manifesting from this portfolio. So at the end of the first quarter, we put most of these loans back to Stage 1, because we have not experienced fundamental deterioration. As far as I can see, it's just kind of Hungary Core, where we had decrease, and it's Croatia where we had decrease, which was material in Stage 2.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

And what is the right level of Stage 1 and Stage 2 provisioning coverage, do you think, in a more normalized environment? I think you hinted that it was around 1.6%, the level that you had at the end of 2019. Is that still valid? Or what's your thought there?

László Bencsik - Chief Financial and Strategic Officer

I mean that's a quite new territory, so to say, so the whole Stage 1 and Stage 2 classification. The old IFRS 9 was basically introduced in '18. And then already in '20, there was a huge shock to the system, an enormous challenge for the methodology.

And this was nothing, but a normal kind of cyclical economic recession. It was a very specially ramped, what happened during the COVID-19. Therefore, it was an extreme challenge for the models, which were obviously built on normal economic cycles and the impact on portfolio quality. I think it's very difficult. So we started with 1.6%. But whether 1.6% was the right one or not, maybe our competitors are right, when they have just 0.5%, right? I think we will only know when we are through 2 economic cycles. So maybe in 15 years, we will know quite well how much it should be.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Just 2 other quick ones. The effective tax rate going forward for OTP Core, I think, was 16% because of the tax change. Is that the likely ongoing effective tax rate going forward?

László Bencsik - Chief Financial and Strategic Officer

Yes.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

And my other one is just on this treasury share swap, the loss, I guess, that was driven by the fact that your dividends are restricted, right?

László Bencsik - Chief Financial and Strategic Officer

Yes.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

So what has to happen -- basically, once you're allowed to pay dividends, that could reverse this. So that would be maybe a fourth quarter event?

László Bencsik - Chief Financial and Strategic Officer

Once this ban on dividend payments is lifted, even if we don't pay dividends in that period, this can be reversed, because this is just a valuation, right? So that's valuation-based. We had to take out this year, because once the restriction is over, this should turn back.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Okay. But for the next couple of quarters, it will remain negative?

László Bencsik - Chief Financial and Strategic Officer

There won't be further negative numbers. I don't think there will be a material number coming in second or third quarter. There shouldn't be much in the second and third quarter. And if the ban is lifted, as it should by end of September, then the fourth quarter, more or less this amount should come back automatically, because then we can again count on this amount to be paid out as a dividend.

(**Operator** Instructions)

Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst

Seeing that there are no further questions, I decided to maybe ask one more. It's about the Funding for Growth Scheme. Do you have any expectations regarding the volumes of this program in the following quarters? Do you think that the first quarter was rather a peak in lending? Is this rate of lending of new corporate lending sustainable for at least a year or so?

László Bencsik - Chief Financial and Strategic Officer

If you talk about the whole market, basically, HUF 2 trillion was already used up from a total volume of HUF 3 trillion, so 2/3 of the total program, as it is defined. I don't know what the intentions of the Central Bank are. Obviously, there's a chance that they further increase the overall size of the program. Originally it started from HUF 1.5 trillion and today it's HUF 3 trillion. They have already increased it gradually. But I don't know whether they will further increase or no. When we talk about the market, roughly there was like HUF 50 billion new loans issued under this refinancing program. This year, it's already somewhat lower. It's back to HUF 30 billion per week new loan issuance. We already see a decrease in the weekly or monthly amounts of loans generated under this refinancing scheme. So far, the banking sector used 2/3 of the total program. I think it's reasonable to assume that for the rest of the year, the current level of planning activity can continue.

I think if I were the Central Bank, I would consider the program subject to the economic growth and economic recovery, what we see in the second half of the year, obviously, if you reach a certain level of GDP growth and economic activity increase and investment intensification, then there will be less and less need for this specific program to continue. But it's up to the Central Bank. So far, they have kept on increasing the program overall scale when we were getting close to the limits of it.

Operator

The next question is from Gábor Kemény, Autonomous Research.

Gábor Kemény - Autonomous Research LLP - Research Analyst

Just a quick one from me on fee income, which was growing, I think, in the mid-single digits in the first quarter. I think you previously talked about fees growing in the -- at the rate of the nominal GDP as a run rate. Is this guidance still valid? And when do you think we are heading towards those levels?

László Bencsik - Chief Financial and Strategic Officer

Yes. Year-on-year, we grew 5%. Given that we had a recession during this period and we had inflation, the blended inflation in the group was probably around 2-3%. So in fact, during last year, overall, we grew more than the nominal GDP in these countries. But that was a very exceptional year. And I tried to explain why we did not grow actually more than what we did. It was specifically due to one specific issue in Serbia, which was a reclassification. So as you see on this slide, one item we reclassified from fee income to cost. So that was just one technical item. But more importantly, Russia specifically had a big decline. And that's a material amount what we generate typically in Russia from fee income. And fee income generation in Russia is not so much linked to transactions, because we are not really a transactional bank, but the generation of new consumer loans, especially, I mean, POS loans. That was not going well last year. We had a year-on-year 11% decline in volumes. Therefore it's not surprising that actually the fee income declined. Then we have Montenegro and Croatia where we had lower levels of transactions, transaction revenues due to lack of tourist activity.

If these countries recover, if tourism recovers and Russian volume growth kicks in, in the second half of this year, then we should get to higher single-digit numbers. Last year was the exception because we had recession and a relatively low inflation, and we had 5% growth. This year, obviously, especially second half, we will have very high GDP growth levels and growing inflation. It might happen that for a short period, maybe nominal GDP growth can be higher than net fee income growth. But if we look mid-term, I think this assumption still holds that roughly nominal GDP growth.

Operator

As there are no further questions, I hand back to the speaker.

László Bencsik - Chief Financial and Strategic Officer

Thank you very much. So thank you for joining us today. Thank you for your very good questions. I wish you all the best. Take care of yourself. I hope we will have -- we'll soon see the end of the COVID-19 situation and life can go back to normal. Have a very nice weekend and be well. Thank you. Bye-bye.

Operator

Thank you for your participation. The first quarter 2021 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.