Strategy and Finance Division
Investor Relations & DCM

OTP BANK
2Q 2019 Conference call
Transcript

9th August 2019

Operator

Dear ladies and gentlemen, welcome to the OTP Bank Q2 2019 conference call. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be the opportunity to ask questions. If any participant has difficulties during the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over to László Bencsik, Chief Financial and Strategic Officer, who will lead you through this conference? Please go ahead.

László Bencsik

Thank you very much. Good morning or good afternoon, depending where you are, and thank you for joining us today for OTP Group's 2019 Second Quarter Results Conference Call. As usual, we have the presentation available on the website as well as the very detailed interim report plus the analyst tables as well. I hope you all have the presentation available. As usual, I'm going to go through quickly the slides given that it's a nice summer day, at least here in Budapest, I will try to be as succinct and focused as possible in the general presentation. And then, as usual, you will have the opportunity to ask a question.

Going through the presentation, Page 2, overall results. In the first half compared to last year we increased adjusted profits by 19% and accounting profits by 15%. These numbers include the acquisitions, namely two, which we executed during the first half of 2019. As you might remember, we acquired Expressbank Bulgaria from SocGen and then at the end of the third quarter, the Albanian bank of SocGen. These two banks have already been included in our first and second quarter numbers. Without the acquisitions, adjusted profit after tax grew by 13%.

On Page 3, you see the adjustments. There were some in the second quarter. You see all the details here on this page. Basically, we've written off goodwill. Obviously, that does not have an impact on our regulatory capital, but had an impact on the P&L. Then, according to the regulatory moves in Serbia, we realized HUF 1.9 billion equivalent of after tax losses in Serbia related to the Swiss franc portfolio conversions, which is an optional conversion taking place in the country.

On Page 4, you see the adjusted profit after tax composition by the different group members. And I have to warn you and also apologize – though this is just due to how we developed during this year – that there are some factors you have to take into consideration when you evaluate our half-year results. One of these three factors is obviously the acquisitions. Within this document we tried to highlight the with- and without-acquisitions numbers, as well. As I said, the overall profit grew by 19% with acquisitions and by 13% without. So that's one type of adjustment. And obviously, in case of Bulgaria, this is substantial, in Bulgaria the growth without acquisitions was just 1%.

The other factor we have to take into consideration is the FX rate changes. If you compare the first half results, then it was only materially meaningful in Ukraine: the hryvnia appreciated against the HUF. Therefore, if you want to understand our Ukrainian numbers and dynamics better, you might want to look at the FX-adjusted numbers. In the back of this presentation, line by line, in the P&L lines, we include these numbers, too. So overall, the profit growth in Ukraine was 42% nominally. But if we exclude the impact of the FX changes, it was only 30%, which is obviously still a robust number.

The third element, which introduces structural changes in our numbers, is the way how we treat and present our non-Hungarian leasing companies. And it used to be a mix because in case of Ukraine, where it has been for a long time a quite meaningful and substantial activity, that has been, for quite a number of years, presented as part of the bank. But in Bulgaria, Croatia and Romania, the leasing companies were used to be presented as part of the international leasing group. Now this line ceased to exist. Now we have only Merkantil Leasing in Hungary as a separate unit. And for all the other leasing companies, we combined them with the banks that operate in the given country. If you want the precise numbers for different growth rates in Croatia, Romania and Serbia, then you have to take this into consideration.

This became important from a group governance perspective because the banks or entities that we are acquiring during this year, namely the SocGen activities in a number of countries, they typically involve quite sizable leasing activities as well, through separate leasing companies. And, from a governance point of view, we want to run these businesses on a country basis, basically, led by the relevant banks present in this country. This is, by the way, in line with how SocGen has managed these companies, and the leasing activities in these countries.

Therefore, on the right side of this page you see, in some cases, even three different numbers for growth. So, for instance, for Bulgaria, you see 42%, which includes the acquisitions and the leasing; then 1%, which doesn't include the acquisitions but does include the leasing; and -1% without the previous two. So that's just some context. Hopefully, this is going to help you to better understand and interpret the numbers that we present.

All in all, I think it represents solid growth without acquisitions, 13%. As you can see, typically the bulk of the profit growth came from the mid- or smaller-size entities within the group, and less so from Hungary and Bulgaria, where we have larger operations. So, Russia was growing strong, Croatia was growing strong, as was Ukraine, Romania, Serbia and also Montenegro. I think it's an important factor that, finally, these relatively mid- or smaller-size banks started to increase their profit contributions to the group.

On Page 5, you see the Group-level P&L lines. And I think there is one development that is important to highlight here. I suggest that you look first to the middle part of this page, where we show the year-on-year changes based on the first-half results without acquisitions. So, operating profit without one-offs grew 14%; total income without one-offs 11%; and operating costs had a 9% growth. In fact, unlike in previous periods where, typically, the profit growth was driven by risk cost and typically by lower levels of risk cost, in this first half this was not the case because operating profit started to grow by a double-digit number without acquisitions, and the risk costs increased compared to the base period last year, the first half of '18. I think that that's an important development, and obviously, this is primarily driven by the volume growth, what we have seen during last year, and which slowly feeds into revenue growth.

Now the other kind of one-off item you see, which was substantial in the second quarter, is related to the Treasury share swap agreement, which amounted to HUF 6.3 billion in the second quarter. Basically, most of it is the dividend, i.e. what we received for these MOL shares what we have as part of this agreement.

If you look at the quarterly changes, they're also quite remarkably high. Now, again, two points here: on this slide, we have not highlighted the without-acquisitions numbers. But obviously, there's a difference between the first and the second quarter; namely, the second quarter does include the entire P&L of the Albanian bank. It's not much, but it's something. All in all, it contributed one percentage point to the operating profit growth.

The other factor which we have to take into consideration here is that there was a weakening of HUF compared to the hryvnia, to ruble and, also, to other currencies as well, to a much lesser extent, but it was there. So, unlike in the first half-year, where it was really only Ukraine where this was materially important, if you compare the quarter-on-quarter numbers, the exchange rate changes were important. In fact, if I were to list the relevant numbers for these growth rates, which do not include Albania and do not include the FX changes, then instead of 14%, we had operating profit growth of 10.7% and total income growth of 5.3% as opposed to the 8%, which also includes the FX changes and also Albania. The good news is that in these metrics, operating costs grew only 0.9% as opposed to 3%, which is what you see here on this page. So, that's just a small remark. On the following pages – in the back of this pack – you will see, by country, these adjusted numbers as well, if you want further information on this.

Turning to volume growth. The second quarter was particularly strong, especially after the first quarter which was not spectacular. If you remember, in the first quarter, the quarterly growth of the performing volumes was only 1%. And then, in the second quarter, we grew 4%. There is a seasonality to this, so it did not surprise us tremendously that it happened. Usually, the first quarter is less strong than the rest of the year. What we are seeing in the second quarter is broadly speaking in line with, or maybe somewhat even better than what we originally expected. I'd like to highlight especially our Hungarian business growth, which was 5% just in one quarter. These are not annualized numbers, obviously. This is just one quarter growth. The growth was reasonably balanced between retail and corporate. Consumer loans grew 5%, housing loans, 3%, and corporate was +8%.

And for other countries, in general, I think across-the-board, these numbers are reasonably strong. Bulgaria 2%; Russia is somewhat slowing down, but if you look back the last 10 years, there is an even stronger seasonality in Russia in consumer lending than in other segments and in other countries within the group. Typically, most of the growth comes in Russia in the second half. But nevertheless, I have to say that the second quarter growth of 1% is rather moderate, which is, to some extent, in line with the macroeconomic slowdown there and also in line with our quite conservative retail lending policies. We obviously optimize for maximizing the net present value of future cash flows, and not just volumes. And when we feel that, from this point of view, it's warranted to somewhat limit new growth, then we do. This is part of the case there. Croatia is strong. Ukraine is particularly strong, but this is obviously a small portfolio there. Especially in consumer loans, the 7% looks quite high but, it's still a portfolio in its early stage of development and it’s relatively small. We're quite happy with the Romanian growth, which accelerated, and also with the smaller countries' growth rates, which started to show good signs.

On Page 7, you see to the year-to-date FX-adjusted performing loan volume growth rates. So, here you don't have to think about the FX changes. And on Page 8, you see the year-on-year growth. There is nothing fundamentally new about this.

On Page 9, we show the quarter-on-quarter deposit volume growth and, again, this was reasonably strong on the Group level, with the exception of Serbia and Albania where primarily corporate deposits left us. In Albania, this was not a surprise, given that typically when we acquire a bank from SocGen, this is usually the course of business as some large corporates associate themselves more with the Western European banks, and they attempt to leave us from a deposit perspective. So, that was expected. I think what is remarkable here is the number in Hungary, which is not a big number, but the retail deposit growth was 1%. We had quite a headwind in Hungary in the first quarter because this new retail government bond was introduced, and it became available from June 3rd for our retail clients. And a substantial part of the retail savings started to migrate to this product. This is an interest tax-free, five-year increasing-rate product. The average yield that can be achieved by retail customers is close to 5%, so this is a product which is hard to beat. And with this headwind we managed to grow our retail deposits despite having very low levels or actually no levels at all of deposits rates paid for Hungarian HUF deposits. The way we interpret this is that it is probably the strength of the brand, the franchise, the services and the level of satisfaction of our customers with our transactions and services that resulted in these numbers. We also included the year-to-date and year-on-year numbers, just for your information, if this is what you are looking for in your models. But there's nothing new in there.

That leads us to the margin question, which is obviously a hot topic. We have discussed it in detail during the last couple of years. As you can see on Page 12, we have seen a huge net interest margin decline during the last five years within the group. As we suggested, we expected for this year a stabilization of the margin on a Group level without acquisitions. Indeed, this is what we seem to see. If you compare the second-quarter without-acquisition margin, it was similar to the first quarter. The with-acquisition margin declined. That's basically a technicality; the difference between the first and second quarter is a technical element, because we acquired Expressbank at the end of January, so it was not fully included in the first quarter. Therefore, only part of the negative impact of the Expressbank consolidation was included in the first-quarter numbers.

Now, I think what is also important is to look at the bottom part of this page because it looks great that the without-acquisitions margin didn't change quarter-on-quarter but we were helped here by the exchange rate. So, as you can see, due to the entity-level margin changes, the overall consolidated margin should have declined. But it did not decline because of the FX rate changes, especially in Russia and the Ukraine, which obviously have a high net interest margin, and therefore, their contribution increased compared to the Hungarian one, and that, overall, helped to stabilize the margins.

The following page, 13, shows the entities – or at least the biggest banks – within the Group, and their marginal development, focusing on the quarterly changes. In Hungary, again, there's some fluctuation. There are some base effects and technicalities. It's not that there's no clear direction, I would say, here, but it’s totally true that this is the market where we had to revise our very original expectations. You might remember that, at the end of last year or beginning of this year, we expected a gradual increase in the reference rate. At the beginning of the year, our expectations were that by the end of this year it might reach the level of the base rate, which is at 90 basis points. Given the developments in the Eurozone, both in terms of monetary policy and also in terms of the real economic growth, obviously, it's quite unlikely that the European interest rate environment will move upwards in the foreseeable future. And therefore, that creates a substantial room for monetary policy in Hungary, and it became extremely unlikely that we would see a material further increase in the reference rate during the course of this year. Having said that, some increase did happen: in the second quarter the closing level of the 3 month Interbank Rate, which is our reference rate, increased by 7 basis points. And the quarterly average increased by 4 basis points. So there is some increase, but it's rather moderate. And we have given up our short-term expectations for a higher or more material quarterly increase in these numbers. That obviously means that this describes a continuous pressure for the Hungarian margin, and we are trying very hard to counterbalance it with new volumes, with new production. So far it has grown, more or less. Given that the second quarter has a strong growth in performing volumes, hopefully, this is going to translate into stronger NII. It will, by definition, in the third quarter. So, there's some hope that the Hungarian NIM continues to be stable and that it might even technically grow somewhat higher than the second quarter level, but certainly, we don't expect a material decline in the Hungarian NIM during the third quarter.

In Bulgaria we had a very long series of declining NIM numbers, and obviously there's some noise here. On this page, we indicated the without-acquisitions numbers, so the standalone DSK Bank net interest margin. The good news is that there was a very small decline quarter-on-quarter in that. That seems to suggest that maybe, in Bulgaria, we are getting close to a point where NIMs might stabilize, but that obviously requires a continuously strong new production of loans. In Russia and the Ukraine, we have seen more meaningful decreases in the margins. These are countries where we have the rate environment decreasing, and where the central banks cut rates. And it's Romania where we see an increase. This is related to our deposit pricing there, which was less aggressive in the second quarter compared to the first.

There were two events quite important for us after the close of the second quarter. Namely, on July 16th and July 25th, we closed two transactions, one and Montenegro and another one in Moldova. They don't appear, obviously, in the second-quarter numbers, so you will see their numbers in the third quarter. I think there are two statements, which we suppose are true for both of these markets. One is that, on a stand-alone basis, these are quite meaningfully profitable banks. Last year, the Montenegrin bank made 17% return on equity and the Moldovan bank 19%, respectively. So, even on stand-alone basis, they provide meaningful profitability. The other important remark is that these are very small banks, as you can see here. Overall, these two are going to increase our performing loan volumes by 2%. So they will obviously not change the overall picture of the Group. Having said that, there are two more acquisitions in the pipeline, a Serbian one and a Slovenian one, both coming from the same seller, from SocGen. And we expect these further two bank acquisitions to close and to be executed during the course of this year. These are much bigger banks, and if we look at their performing loan volumes and we compare them to our volumes at the end of the second quarter, then they would increase, on a pro forma basis, our performing volume by 15%. So, these four banks together, if we close these transactions, can — contribute a 17% growth in the performing volumes by year-end. I think, that is meaningful and fundamental.

Obviously there's a price for it. We also have to pay for these banks; they don't come for nothing. On Page 16, we show you the level of capital – what we have and what we accumulated. Just to remind you, during the course of this year, we are conducting quarterly audit reviews, and therefore we are allowed to include the period results minus the calculated dividends based on the EU rules of calculating dividends: where an entity does not have a dividend policy per see that is exact enough to result in a number. Therefore, you can see a quarterly increase in the Common Equity Tier 1 ratio. This was 15.9% at the end of the second quarter, including the quarterly results. As we said, the expected pro forma impact at the end of the second quarter of the four acquisitions, which will have to be concluded for this year, is 2.8 percentage points. So, paying for these banks is going to cost us 2.8 percentage points on a pro forma basis and second-quarter basis in terms of the Common Equity Tier 1 and also the Tier 1 ratio, which are the same in our case.

There was another important event in July. We issued a Tier 2 bond, and this was, in our understanding, the first MREL-eligible issuance in the region. We regard it as quite successful. There was a strong demand for this paper. We ended up having 2.875% fixed rate. It's a 10-years non call 5 structure, where we have the right to call back the bonds after 5 years. For a long time, we have not been present on the debt capital markets or the equity markets, and this is the first time that we reappear. We believe that this is a decent benchmark that we created, and it shows the strength of the franchise that we have.

In terms of risk cost and portfolio quality, Page 17 shows the Stage 3 ratio development. It further declined to 7.7%. Coverage slightly increased compared to the first quarter. The 90+ days overdue loans ratio (DPD90+), which is a subset included in this 7.7%, also decreased. It ended up being 5.5% at the end of the second quarter. At the end of the presentation, there are some more technical details on the portfolio quality. The risk cost rate for the first half ended up being 19 basis points, it's somewhat lower than our original expectation was for this year. We expected it to be similar to last year, which was 23 bps. But just to remind you that in our case, we have spotted a tendency in our provisioning to provision more at year-end. This might happen this year as well.

Nevertheless, these numbers suggest that the underlying risk environment has not changed. It's still quite supportive. And, if you look at our more than 90 days past due loan formation (Page 26), it increased in the second quarter compared to the previous ones. But this increase was primarily due to one corporate default in Russia and a small number of corporate defaults in Romania. I would not draw any systemic conclusions from these corporate defaults. It seems that, for a long period of time, we have had basically no sizable corporate defaults and now they happened to happen in two countries during the same quarter. I don't think that there's a kind of systemic conclusion to be drawn from that fact.

I'm sure you will have many questions regarding our cost and cost increase, especially in Hungary. Therefore, I just wanted to give you a kind of longer-term, overall, higher-perspective view on our cost efficiency, and that's on Page 18. What it says, basically, is that cost-to-assets, which is one metric for measuring banks' efficiency, improved. If you take the year 2010 as the base, where our cost-to-income ratio was 45.2%, our cost-to-assets ratio was 3.6%. Now this ratio, versus then, has declined by 7%. In the first half of this year, we were at 3.4%, which is the lowest for the last five years. Then the middle line is the income per average assets, this is basically the total revenue margin. There you see a fundamental, big change. There was a more than 20% decline in the total revenue margin. And the cost-to-income ratio is basically a combination of cost-to-assets divided by revenues or income-per-assets. As income-per-assets decreased by 20% despite some improvements in the cost-to-asset ratio, we ended up having a higher level of cost-to-income ratio by 18% compared to the 45.2% in 2010. Now, this is not an excuse. It's just trying to show you the problems. Revenue margin declined, but that revenue margin, unfortunately, has nothing to do with operations. That's just purely pricing. Lower revenue margin doesn't mean less work or less costs – rather, the opposite. Despite the fact that we managed to improve our cost-to-assets, our cost-to-income just worsened. One piece of good news is that if you compare last year to this year, we seem to have managed to have some improvement. That assumes that we can stick to the kind of cost development on a quarterly basis as the one we have seen so far in the first and second quarters.

And, now, expectations. Again, at least for this year, we are quite optimistic regarding the countries where we operate. It's only Russia where we see the GDP slowing down materially, and this is, in our view, primarily due to policy factors – conservative fiscal and monetary policy slowing growth more than what its potential is. But, certainly, if you look at Hungary and the level of growth there, our expectations are almost at the level of last year: we expect a 4.8% GDP growth for this year. And for the rest of the countries where we are present, Bulgaria is quite strong; Romania is quite strong; and we see some ups and downs in the other countries. But in general, for the course of this year, we expect continuously positive environments, supporting environments. And the recent developments in Ukraine might fuel further optimism for the future of the Ukrainian economy. Having said that, if you look at the broader picture, then obviously this picture gets less cheerful: the Eurozone is slowing down, Germany is slowing down, and we have the looming Brexit threat, and the global trade war, and so on and so on. So, mid-to-long term, that will obviously create challenges for these countries as well. But if you just look at the fundamentals of growth within the region, they continue to be strong. And, at least in the short term, we don't see reasons for particular concern.

That was the kind of high-level, general part of the presentation. We included a number of slides explaining the P&L lines. Here, we tried to give you more detailed information and show adjusted numbers with and without leasing, and also the FX-adjusted numbers in detail. For the sake of efficiency here, I'm not going to go through it in detail. But, obviously, through your questions you might zoom in on some of these points and then we can elaborate further on them.

I already passed up on Page 26, which shows you the 90+ days past due loan volume developments and the time series comparison. And again, you see two numbers speaking out. One is the second quarter in Russia and Romania. In Russia out of the HUF 16 billion, HUF 3.7 billion was attributed to one corporate client. And in Romania, out of the HUF 6 billion, HUF 5.7 billion was related mostly to the large corporates and, to a smaller extent, to SMEs.

The last two slides give you more details on the Hungarian market position, in terms of market share, and activities in retail and corporate. As you can see, our position remained strong. Maybe there's one piece of information worth highlighting. There is a new subsidized structure for retail clients in Hungary. It started in July. It was not present in the second quarter. None of the numbers reflect this, but it's going to be material and important. I'm sure that when we discuss the third-quarter numbers this is something that is going to be quite important and visible. It's basically a subsidized loan. It's difficult to translate into English – the best translation is probably 'baby shower loans'. The literal translation would be that 'new-born baby expectations' or 'expecting loans,' something like that. The primary target or purpose of this structure is to boost the birth of new children in Hungary and improve the demographics and, therefore, it's a complicated structure. It's a state-guaranteed loan. It's basically a free-purpose cash loan without collateral to Hungarian women who are less than 41 and who commit to have children. If they have three children, they don't have to pay back the loan and they don't have to pay an interest. If they have two, then some part of the loan is paid by the government, and if they have one, then a lesser part – so it's a complicated structure. We're going to talk about this. It's quite new. Again, it started in July, but it is going to develop into a sizable volume in Hungary. But, so far, it has had no impact on the second-quarter numbers, obviously. So that's more kind of pointing to the future and potential future topics we are going to talk about after the third quarter.

All in all, this was what I intended to tell you as part of this general presentation. I would like to ask you to ask your questions. So please, operator, open the floor for the Q&A session.

Operator

Thank you. Then we will now begin our Q&A session. If you have a question for our speakers, please dial 01 on your telephone keypad now. Once your name has been announced, you can ask a question. If you find that your question is answered before it is your turn to speak, you can dial 02 to cancel your question. If you are using speaker equipment today, please lift the handset before making your selection. One moment please for the first question. We've received the first question. It is from Anna Marshall of Goldman Sachs. Please go ahead. Your line is now open.

Anna Marshall

Good afternoon. Thank you for your presentation. A couple of questions from my side, please. The first one is on your M&A strategy. You've closed two more acquisitions. You have two more remaining to close until the year-end. Is there more in the pipeline or, indeed, you're approaching the end of this part of your strategy, and you're going to move towards a time where you've considering increasing, say, dividend pay-outs? So this is the first question.

And the second question is: how to interpret the lack of an outlook or management expectations pages in the presentation? Does this mean that the outlook is under review? Or that it remains unchanged? Thank you.

László Bencsik

Yes. So, the pipeline: in terms of acquisitions, there is nothing concrete or serious I could talk about as new. So, the most likely scenario is that, indeed, when we finish the remaining two acquisitions, then for a period of time, we are not going to acquire further banks.

I mean, this is the situation today. Obviously, it is partially also driven by demand. It's also because we don't see so many assets which would be tremendously interesting for us. You could draw up scenarios where, I don't know, some of our regional competitors decided to withdraw from the region or things like that, and that could justify our strategy to be revisited. But if you are asking about the current pipeline, it doesn't include any serious further acquisition. From that, I think it's reasonable to interpret that if we continue to accumulate profit in the way how we do, then that will naturally lead to a higher return to shareholders. But this is something we're going to talk about concretely when we finish this year. As we said during the AGM, we were going to come up with the dividend policy after the end of this year, in first quarter. But I think there's some reason to interpret the numbers in a positive way. If you look at our ROE, especially in the second quarter, it was above 20%. That's clearly quite a strong performance. It seems that we are creating room for those outcomes as well.

Now, regarding the outlook, indeed, we believe that we are more or less kind of operating within the framework of what we suggested or indicated as a guidance. If we go through these lines – I mean above 15% ROE – and if you look at the first-half numbers, then we are clearly well above that level. The margin is flattish and not lower without acquisition than 4.25%. That was the other guidance we made. Again, looking at the first half, it seems that we seem to be within that perimeter as well. Risk cost rate is slightly lower in the first six months than it was last year. But I already hinted that it doesn't necessarily mean that we are going to be lower for the whole year as, for some reason, it has happened so far that we tend to provision more at the year-end. I already told you at the end of this first quarter that the original 4% FX-adjusted cost growth for us is a tremendously stretched and difficult target to reach. This depends on what we have, but there is some risk that we are not going to reach that 4%. Hopefully, this is compensated by revenue factors.

I think what is very important here is, obviously, the last part of the guidance we made, which was related to the volume growth. We indicated around 10% of volume growth without acquisitions. The first half was 5%, and it was broken down between quarters into 1% and 4%. We do see some acceleration compared to the first quarter. Again, this doesn't justify a guidance review. I think that out of the two options which you have given me, it is more that we seem to develop according to the original guidance.

Anna Marshall

Very clear. Thank you.

Operator

The next question is from Máté Nemes of UBS. Your line is now open. Please go ahead.

Máté Nemes

Good afternoon, and thank you for the presentation. I have two questions, please. Firstly, on Hungary, it seems that corporate lending is still at a relatively high level. I think your original expectation was that we should be seeing some moderation. Could you talk perhaps a little bit about the demand for corporate lending in Hungary, and perhaps also in the region? And also, in the context of the some of the soft data or PMIs indicating a slightly weaker sentiment, what are you seeing in this space?

And then, secondly, given the potential of the ECB easing further and with less pressure also on other regional central banks to perhaps hike or manage interbank rates higher, would you mind sharing with us the main interest rate sensitivities in the largest operating countries? That would be helpful. Thank you.

László Bencsik

On corporate lending growth, the year-to-date growth was 7% in Hungary. Last year, we grew by 28%. I would say that there's some visible slowdown. I don't think we are going to reach 28%, so it's going to be materially less, and I think the first half with 7% is a good proxy for the dynamics. On this line, I think we are in line with what we more or less expected. Our expectation for the market growth for this year is basically 15%, which is two times our half-year growth. So, it's also in line with that.

In terms of our sensitivity to the Euro rate, basically a 10 basis points decrease in the 3-month Euribor would result in a HUF 1.3 billion reduction on an annualized basis in the net interest income. This is more or less symmetrical, so a much less likely scenario is that it increases but, if it did, that would result in a HUF 1.3 billion higher NII. Now this is for the whole Group, consolidated. Is that what you asked for?

Máté Nemes

Yes. Yes. Thank you.

Operator

Thank you. The next question is from Simon Nellis from Citibank. Please go ahead. Your line is now open.

Simon Nellis

Hi, thanks very much. Could you just repeat those numbers on the sensitivity again? I didn't quite catch that.

László Bencsik

A 10 basis point decline in the euro reference rate – the 3 months Euribor – would decrease our NII by HUF 1.3 billion annually.

Simon Nellis

And then vice versa if it goes up?

László Bencsik

Yes. But that's an unlikely scenario.

Simon Nellis

Does the same relationship hold with the BUBOR rates? I think you said 10 basis points is around a HUF 2 billion impact?

László Bencsik

Yes. Right.

Simon Nellis

So no change there?

László Bencsik

No. It was HUF 2.2 billion, but it's down to HUF 2 billion today. So after the second quarter, it's HUF 2 billion.

Simon Nellis

Right. Okay. And can I ask a question just on fees? You obviously explained the jump in the fees in the quarter at OTP Core. But is this the new run rate? You had kind of 12% growth quarter-on-quarter even if you strip out the one-offs.

László Bencsik

I mean, each year, if you look back into the past, there has been a seasonality. Usually, the first quarter is less strong in fees, there's a seasonality. Now, on Page 23 we tried to explain the quarterly growth, which was nominally in Hungary HUF 6.5 billion, basically HUF 3.4 billion is attributable to one-offs. There are kind of different taxes accounted in the first quarter and the second quarter and vice versa. During the previous two years, we had a negative impact of the repricing of the retail government bonds' distribution fees. The fees for the distribution of retail bonds have been cut tremendously. And that had a huge negative impact in the prior two years. But this is over now, now there is no difference compared to the base, because there haven't been further changes since the beginning of the first half of last year in the pricing. Therefore, the volumes are going to drive the Hungarian fee income from distributing retail bonds. And this line particularly was strong in the second quarter because this new retail bond structure came out – it's called Hungarian Government Bond Plus. It provides retail investors with a very strong investment opportunity, and it became extremely popular. This generated revenues – securities distribution fees – in the second quarter, which was strong.

I would say that the change compared to the last few years is that we are no longer subject to declining fees in distributing securities, which are a big part of our business because we are fundamentally a retail bank in Hungary. We have 32% market share in retail savings, so for us this is a sizable business. And, if anything, this is growing hugely by volume. Therefore, yes, we should see the positive impact of that in the fee structure in the future.

What I'm trying to say is that there are no further structural changes in the fee income and in pricing, so the revenue should be volume-driven. And volumes are strong, transactions are growing fast and lending is growing. In general, there's a growing activity here that we can witness.

Simon Nellis

Okay. And maybe just one other question on the Russian margin developments. I mean, there was a pretty steep drop in NIM. Is that going to be sustained? What are the dynamics there?

László Bencsik

This is a story we started a number of years ago. Partially, this is driven by regulation, but in the second quarter particularly, it was also driven by deposit pricing. We increased deposit pricing and obviously that came at a cost. It's a decreasing rate environment in Russia. If anything, it should even decrease faster than it has. So, in terms of the external rate environment, I don't think this trend will turn around; it's most likely to continue. Obviously, the decline will be smaller and smaller as the nominal number we talked about gets smaller and smaller. But I don't expect this trend to turn around soon.

Simon Nellis

Right. Okay. And then just one last quick one. When do you expect the Serbian transaction to close? Do you think it will close this year? Or is it likely next year?

László Bencsik

Definitely this year. We are working hard to close it in this quarter.

Simon Nellis

Right. Okay. Thank you very much.

Operator

Thank you. The next question is from Gabor Kemeny of Autonomous Research. Your line is now open. Please go ahead.

Gabor Kemeny

Hi. A couple of questions, please. Firstly, on the Russian consumer lending regulation, where a new round of tightening will take effect in October. Then, this links the capital requirement to the PTI. On consumer loans, what do you expect from this regulation in terms of capital and growth in Russian consumer?

And the other one is on the margins. I think you show an 8 basis point support from the FX rate changes in Q2. So, your clean NIM has been 4.25% in Q2, if we take out the effect of the FX changes?

László Bencsik

Yes. That's what it means. The answer to the second question is yes.

Regarding your other question, what we expect is rather a moderation in volume growth. We expect less of an increase in further capital requirements because the high APR lending is less and less. Especially what we've done from the bank is less and less. This is the reason why the NIM is getting lower and lower, because we have less and less high APR lending. The capital hit would be quite moderate. But I think what we are seeing here is that the difference between these products – the POS and other types of unsecured retail loans – is getting smaller and smaller, because the pricing is getting closer and closer.

In general, I think that if you look at the overall consumer lending growth in Russia, it is tremendously robust compared to the GDP growth. I think this potentially concerns the regulator as well. Now that we more or less gained back the volumes that we lost during 2014 and 2015, we would be okay with a lower growth rate there and a more controlled risk profile. It is probably an exaggeration, but we understand why these regulatory changes happen, and we understand that they may have a positive impact on the market by basically limiting excessive risk-taking and exuberant growth of portfolios, which usually don't lead to a very good end.

Gabor Kemeny

Okay. Understood, thank you. And just to follow up on the margins, what do you think is the likelihood that the margin will drop below this Q2 level, which was I think in the last couple of quarters? Because, if I understand it correctly, then adjusted for the FX changes, there was a bit of a negative development here.

László Bencsik

I can only refer you back to our guidance, which literally said that the net interest margin started to flatten out in '18, and it may not fall below the second-quarter 2018 level of 4.25% without new acquisitions in 2019. This is what we uphold.

Gabor Kemeny

Okay. And this was based on a constant FX assumption presumably?

László Bencsik

Not necessarily.

Gabor Kemeny

Okay. So, did you assume any FX changes when you formed this guidance?

László Bencsik

Certainly, we had an assumption, based on the FX rates. Yes, we had an assumption. If you are asking about expectations, our expectations have not changed. The exact guidance that we gave for the expected NIM, we still think that this is the most likely scenario for the course of the year.

Gabor Kemeny

Okay. That makes it clear. Thank you.

Operator

Thank you. As there are no further questions, I would hand back to you.

László Bencsik

Okay. Thank you very much. Thank you for joining us today. Thank you for listening to the presentation, and thank you for your very good questions.

It's midsummer, so I hope many of you are just ahead of a very relaxing summer vacation. Some of you have probably done that and are already very relaxed but, in any case, I wish you all the best and a very good summer. And I hope that you will join us when we discuss the third quarter results, on November 8th. Again, thank you very much, and goodbye.

Operator

Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.

Note: unabridged transcript with minor English stylistic corrections.