Strategy and Finance Division

Investor Relations

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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 2024 Conference Call of OTP Bank. This conference will be recorded.

May I now hand you over to László Bencsik, Chief Financial and Strategic Officer. László, please go ahead.

László Bencsik – Chief Financial and Strategic Officer

Thank you. Good morning or good afternoon, depending on where you are. Thank you for joining us today on OTP Group's 2024 First Quarter Results Conference Call. As usual, the presentation, which we are going to use is available on the website, so you can download it. But at the meantime, we keep them projecting is together with this, we see it.

So, looking at the first quarter results and the high-level messages, we like to communicate about ourselves. I think on a high level, there has been no change. All those factors became more transparent and more articulated in terms of our market share in the region in terms of our profitability, liquidity, capital position, all getting stronger and stronger, and commitment remains solid and stable for ESG targets.

Now if you look at the numerical results for the whole group, we achieved HUF 240 billion profit after tax. As we previously indicated, we have changed some of the presentation methodology of our results. We don't intend to use one-offs or adjustments anymore, unless something really huge happens in terms of badwill or a huge gain or loss on selling an asset, but most likely, these adjustments will just disappear. There will not be separate adjusted profit. This obviously does not have any impact on the underlying accounting standards, approaches, methodologies and the structure of our underlying financial statements, only have effects on the way how we present them when we communicate with you. So, we are going to show less or no items as one-offs basically, and everything goes into profit after tax. Some of you may like it, some of you may not like it. It will probably cause some inconvenience, but we are moving from one to another one. We try to do everything we can to ease and facilitate this change in the analyst tables, in the excel tables that we have on the website and also in our written word document quarterly report, we presented the numbers in both presentation methodologies, the old and the new. We have a page in the word document close to the end, which describes in detail how we reach the new methodology or a new presentation, methodology numbers for 2023, starting from the old ones. If you have any remaining questions, please don't hesitate to contact our IR team, and they will be helping you to understand the changes. But I hope this is going to be for the better.

So therefore, we don't show anymore adjusted numbers, only the profit after tax numbers. On that line, we had a 23% y-o-y increase and almost 2x improvement compared to the fourth quarter. The lead indicators, net interest margin stayed at the level of the 4Q, which is good because 4Q is quite a good level, especially compared to the first quarter last year. Now this quarterly change, as we explained during 2023 was driven by the changes in Hungary and the rapid rate normalization in Hungary, which improved substantially our names in OTP Hungary.

Risk costs was actually positive. We released provisions primarily in Hungary, but also in Croatia. This was due to the usual IFRS 9 forward-looking macro expectations updates. As long as we move ahead in time and the macro expectations improve quarter-by-quarter, we should have somewhat less provisions, and this was exactly the case. But it's the opposite should the macro expectation deteriorate for the future, we should provision somewhat more. And that's what caused this negative number, so this release and the other factor, which is very important. I'm going to talk a bit more about this that risk was started to normalize rapidly in Uzbekistan. Therefore, overall group level, we have less risk cost and the profitability of our operation in Uzbekistan is getting to the level where we expected it to be this year.

Nevertheless, we booked the previous one-off items, namely the special tax, bank tax in Hungary and the windfall tax in Hungary, which after-tax. These 2 items, as you can see on the page, is HUF 39 billion. There were other items across the group, which were booked as costs in one go in the first quarter despite the fact that, fundamentally, they should have been spread over the whole year and accrue. But due to the accounting rules, our auditor insisted to book them in the first quarter. The biggest of these items was the deposit insurance fee in Bulgaria, which amounted to HUF 11 billion equivalent in the first quarter. These are all negative numbers. So altogether, we had HUF 27 billion equivalent profit after tax impact, both in the first quarter, which really applied to the whole year. So, if we were only to account in the first quarter, the $^1/_4$ of those, then the first quarter profit after tax would have been HUF 283 billion and ROE close to 27%. So that's the run rate if we were to accrue these one-offs in the first quarter, then we had this number as profit after tax.

Next slide is about the P&L, but there's nothing new on there. Maybe we skip to the Page 5, where we talk about the Hungarian performance. Here, the profit after tax is HUF 50 billion. Margin stayed close to the fourth quarter number, which is good. Cost-to-income ratio continued to improve. As you can see, we had a largest release item in risk cost in Hungary. Therefore, the risk cost rate was actually negative. That means it contributed to the profit of the entity. Most of these one-offs appeared in Hungary, HUF 40 billion. So again, if we had this HUF 40 billion evenly distributed over the year then the first quarter results would have been HUF 80 billion, HUF 30 billion more than the actual number.

A few words about the business performance in Hungary. On the retail, we see a very positive development in amount. Both mortgage loan and consumer loan namely cash flow amount increased substantially in the first quarter. So, if you compare to last year first quarter, then the new contractual amount – that is the new loan contracts, which were the amount of the new loan contracts that were signed with clients – for mortgages increased almost 3x. The entire market in Hungary, it was more than 2x increase. Therefore, our market share from new production, from new contracts increased and exceeded 36%, as you can see on this slide. On the consumer lending side, cash loans, similar positive development. Our contractual amounts increased y-o-y by 67% and the market by 48%. Therefore, our market share from new contractual amounts increased. We may not have the same magnitude of improvement for the whole year, but it is definitely a strong start of the year. Especially in housing loans and mortgage loans, this is a herald of a much stronger performance than last year, which was rather weak. Last year was quite a substantial drop back, almost 50% decrease happened last year compared to 2022. We may not get back to the 2022 level this year, but we can easily get up to 40%, 50% growth compared to new production last year. I think, on both sides, on the mortgage loan side and on the retail cash loan side, these are good signs for increasing economic activity. It means that consumption generated loan demand is increasing.

Consumption is increasing, retail consumptions and the households are ready to start investments and therefore, retail investments, which are mostly done in the form of housing, start to pick up. That's an overall good early sign of economic recovery. I think certainly, these numbers are better than what we originally expected, I would say, considerably better than what we expected at the end of last year. In terms of the savings market, as you can see, our deposit share increase and the good news is that retail deposits grew 3% in this quarter for OTP. That's, again, a very good improvement compared to last year. More about this later on.

The next slide talks about the corporate situation. Now this is quite contrast to what we see in retail, because in corporate, we don't yet see increasing loan demand. This is not just Hungary, across the Central Eastern European countries, we see a rather mild or limited demand for new corporate loans. Typically, corporate clients are doing very well financially. They increase their cash reserves, and they rather pay back existing high interest rate credit lines as opposed to utilize new ones. And they seem to be somewhat more cautious or somewhat delaying new investment decisions. That's what we see in Hungary, and that's what we see in all the other CE countries. Therefore, corporate loan demand and loan growth has not yet manifested. This is probably a second step. We see that clearly already happening in retail. And again, not just in Hungary, but you will see that basically across the region, that retail loan demand started to pick up. I guess, corporate loan demand will come in the second wave. When exactly? Probably second half of the year. But it is hard to tell what exactly the time delay, the time difference between these 2 revivals, retail loan demand and corporate loan demand will be, maybe there will be also differences country by country.

If you look at the financial performance of the entities outside Hungary, I think the picture is very positive. All of these entities contributed positively. The big turnaround here is clearly our bank newly acquired bank in Uzbekistan, Ipoteka, which booked HUF 11 billion equivalent of profits in the first quarter. That translates into almost 30% return on equity, which is higher than what the whole group made last year. So and now I think we are getting to the level in Uzbekistan what we expected when we brought the bank. We are very happy to see these results coming through, because a lot of our colleagues are working there hard to make this happen and the potential certainly is very large.

I mentioned at the beginning that in case of Bulgaria, there was a rather large item, HUF 11 billion equivalent. The cost of the deposit insurance fees, which were for the whole year booked in the first quarter in the form of HUF 11 billion. So if we were to adjust with that, then the quarterly result run rate is more around HUF 50 billion.

Just a quick look at the different P&L lines. In terms of net interest income, 30% y-o-y growth without acquisitions. If we include the acquisitions, then it was actually 40% y-o-y difference, in the first quarter. NKBM, the newly acquired Slovenian Bank was only included for February and March. So in last year results, NKBM was not included yet in January. The other item, which was missing from the current group a year ago is Uzbekistan. Uzbekistan, we consolidated it in terms of revenues in the third quarter. So in the first half of the year, in the basis where we're missing. Without the effect of acquisitions, 30% y-o-y growth. In terms of NII quarterly 2%. We had small some noise in different cases, especially in Hungary, we have this slight decrease. But to be fair, it's rather fundamentally, it's an increase because there was a quite big positive one-off effect in the fourth quarter, HUF 13 billion. So this minus 1% development was despite the fact that the base was HUF 13 billion higher just due to technical one-off elements. So actually, this minus 1% decline translates into HUF 12 billion improvement if you take out of the base effect. That is due to the growing deposit retail deposits effect primarily, which is quite positive.

In Bulgaria, the yearly growth and especially the quarterly growth is not driven by NIM, it's driven by volumes, a very strong volume dynamic. Quarterly basis, in particularly, there's a technical reclassification between revenue lines. This is going to be permanent. You will see that the margin what we have in Ipoteka.

In Russia, there is an improvement. More than half of it was related to technical negative one-off appearing in the first quarter and basically, that's it.

Net interest margin was in Hungary, more less stable, which is good. You can see the quarterly improvement compared to a year ago, which is very strong. In general, in euro or euro-linked countries, we have y-o-y improvement and quarter-on-quarter more less flat rates. There's this improvement in the Ipoteka in Uzbekistan, which is again technical, but it will remain with us. This is a permanent reclassification of certain revenues. In Moldova, there was a big drop y-o-yin the net interest margin. It's not really important for the overall group as such because it's quite small. But as a story, I think it is very interesting. I don't remember seeing such a huge improvement in 1 year or decline in y-o-y rate environment. In Moldova, a year ago, in the first quarter of last year, the base rate was 20% or higher. Today, the end of the first quarter, it was 3.75%. So incredible improvement and recovery in terms of the rate environment, and today, it's lower than the euro, which I did not expect to happen a year ago.

Talking a bit about volumes and starting with loan volumes. Overall, 1% FX-adjusted performing loan growth, but Romania was negative. We showed the Romanian numbers, more less, is if everything was normal, but you have to take into consideration that we already signed the share purchase agreement. So this bank is about to be sold. If you look at our financial statements the Romanian operation is shown as for sale, therefore, it's not consolidated as line by line. Nevertheless, we show the dynamics as if it was normal. If we take out Romania, which we will most probably during the course of the third quarter this year, then with Romania, the growth was 2% on the group level.

I think the most important number here is probably the sheer size of the portfolio is the Hungarian mortgages, which in 1 quarter increased by 2%. This trend, which I just explained that we see strong dynamics in consumer lending and in mortgages across the group, I think it's quite visible on this slide that we had in the first quarter, 4% growth in consumer loans and 3% in mortgages. As you can see, corporate growth overall negative and rather muted across the board. That's the comment I made that it seems that corporate loan demand revival will have time lag compared to the retailer.

In terms of deposits, overall group level 1%, so not much has changed, but very importantly, Hungarian retail grew 3%. This is fundamental for the profitability of our Hungarian business and has a rather material impact on the group level as well, just because of its size. So that's also quite important. What you see here at 3% growth just in one quarter. You probably remember, this is one of the pain points. It used to be one of our pain points in Hungary and for the whole group that for a period of more than a year, retail deposit growth was negative in Hungary, and that was extremely painful for us, given that we don't pay much interest on these deposits, and therefore, they have a strong profit contribution.

Fee income. Year-on-year, without acquisitions, they went up by 14%. First quarter, they went down q-o-q 9%. There's always this seasonality. In Hungary, we have one-offs as usual each year. So, we had positive one-offs in 4Q and negative one-offs in 1Q. The difference in one-offs is HUF 4.6 billion negative, so actually more than the decline. Usually in the first quarter is just seasonally worse than all the other quarters. The other bigger item here is the last on the list, the fund management. You probably remember that during the fourth quarter last year, at the end of the year, we received the management bonus due to the very strong performance compared to the market of the asset management company.

Other income. In Hungary, there's a decline, and this is going to be a recurring item during the year because last year, we had this very steep decline in the rate environment, and that we use a positive fair value adjustment revaluation result in the baby loan and subsidized mortgages volumes in Hungary. Altogether for the whole year, the impact was HUF 80 billion. That HUF 80 billion is unlikely to appear this year. In fact, the first quarter fair value adjustment was negative. While last year in Hungary, we had this strong positive contribution from the fair value adjustment of the subsidized products, this year, we expect plus/minus 0. Some fluctuation around but more less stable level. This is going to be a structural difference between last year and this year. Therefore, other income, especially in Hungary, we expect to be much lower than the one last year.

Costs, we are at 9% up without acquisitions, FX adjusted compared to the first quarter last year. This is still due to the high inflation, especially last year, and most of the wage increases actually happened in the second quarter last year. The annual wage inflation impact is fully included in this y-o-y comparison of the first quarter numbers. The good thing is that Hungary slowed down, it is only 4%. Last year was one of the highest. I think we have succeeded in slowing down the OPEX growth in Hungary. In most of the other countries is typically the y-o-y growth is just inflation and primarily wage inflation driven. There is one country where we have negative number. It's in terms of y-o-y change, Albania. In Albania, we concluded the merger at before the end of last year. Now we are realizing the cost synergies, so it is minus 13% as it's the sign of these cost synergies being manifested.

In terms of risk costs, again, very benign, positive number release in the first quarter. As I said, most of this release came from Hungary. The good thing is that Uzbekistan is down to HUF 8 billion, which is a substantially lower level than last year. It's still a high-risk cost rate, 2.5%, but much lower than what we had last year, above 10%. We are still not exactly where we want to be, but I think the progress is very positive and actually quite fast.

In terms of portfolio policy quite stable. The Stage 3 ratio was flat. If you take out Russia, Ukraine, Uzbekistan, they're higher ratio of countries, we ended up improving 10 basis points in the Stage 3 ratio. We continue to as much as allowed by regulation beyond the more conservative side of provisioning. That has not changed, at least compared to our peers.

In terms of capital, the first quarter, a slight increase in the common equity Tier 1 ratio. You see here the waterfall what happened exactly and what elements contributed to this change, positive and negative. Basically, nothing particularly exciting. There was this 20 bps minus effect, which you may not expected the regulatory changes, that's just the normal phasing out of the transitional adjustments that we have in our capital structure.

The next slide is about the liquidity situation. If you look at our liquidity ratios, well above requirements, well above peers. Liquidity coverage ratio 243%, net stable funding ratio of 159%. Overall, net loan-to-deposit ratio is 73%. Another interesting number on this page is wholesale debt to total assets ratio, which at the end of the first quarter, it was 7%. I think it's interesting to look into the historical perspective. In 2008, when the financial crisis hit us, it was 25% and the loan-to-deposit ratio was 127%. We are much, much more liquid and better funded than not today than then.

We did one issuance, senior preferred at the end of January. That increased our MREL ratio, which you saw on the previous slide to 26.2%. We don't have any maturity this year, but there are 2 papers which come into the call date window, a senior preferred and the Tier 2. We'll make the decision what to do with this in time and accordingly. Depending on what happens with these and other factors, we expect to do 1 or 2 more MREL eligible issuances this year and maybe some further private placements as we did last year in order to more diversification of our funding base. So higher diversification in our funding base.

In terms of ESG, I think we are progressing well on our green targets. We primarily approach it in a constructive way and in a way of increasing the green loan book. Despite the overall lack of growth in corporate loans and very low new demand, we managed to increase the green loan stock in the group by almost 7% to HUF 701 billion of equivalent, which is a good thing and a good step in the right direction.

In terms of our expectations, not much has changed. The macro expectations remain pretty similar to what we presented you when we published the year-end numbers. Therefore, the management expectations, we decided not to change them. They remain as they are, but maybe some colour and comment to them without actually factually changing them.

In terms of loan growth, as I explained, retail loan growth is quite dynamic and strong, even stronger than we originally expected. On the other hand, corporate loan growth is below our original expectations. So retail is doing better, corporate is doing somewhat better. Net interest margin, first quarter was clearly better than last year. Last year, we were at 3.9% for the whole year and the first quarter this year was 4.3%, which equal to more less or almost same as the last quarter last year. This is somewhat better than we originally expected, and this is just related to the fact that the rate cuts have not happened yet, and they are pushed ahead in time and then relate the cuts happen. So, the higher the longer, typically the better we are, especially in Europe, but we are at a point with the HUF rate sensitivity that it doesn't really matter. In this between 6% and 8% or 5.5% and 8% range, our sensitivity is actually very low.

Cost to income ratio, I think first quarter was close to 45% from below, it was 44%. That's in line with what we expected.

Risk profile. The risk cost rate was in the first quarter was better than last year. But what we originally wanted to say there was the portfolio quality in general, we expected this year not to be very different from last year, except Uzbekistan where we expected some improvement. Indeed, that's what happening, the underlying portfolio quality seems to be quite stable as it was last year, and we already see improvements in Uzbekistan.

We have a lower ROE than last year, but in the first quarter that was due to these items, which we booked in the first quarter, which I talked about at the beginning, but they actually apply for the whole year. If we adjust with that, and if we were to accrue those cost items, then we would be pretty close to last year 28% level.

I think that's all, so this is what I wanted to say in the presentation. I'd like to give you the opportunity and actually ask you to ask your very good questions. Thank you.

QUESTIONS AND ANSWERS

Operator

The first question is from Máté Nemes, UBS.

Máté Nemes – UBS

I have 3 questions, please. The first one would be on net interest margin or more specifically on interest rate sensitivity to euro rates. Would you be able to give an update on that front, better that has changed? Any colour on that front would be helpful.

The second question is on operating costs. It seems like countries like Bulgaria, Croatia, Slovenia is still showing quite elevated cost growth in the double digits y-o-y. I'm just wondering whether you're seeing any offset to that? Or is that perhaps driven by base effects in 1Q versus the remainder of the year? Any colour on that would be helpful.

And the last question is on capital. Obviously, your CEO and Chairman made some comments with regards to potential acquisitions and the bid submitted. I'm wondering if you could perhaps comment with regards to the lowest CET1 capital ratio that you would be comfortable running the bank, even if it's on a temporary basis.

László Bencsik – Chief Financial and Strategic Officer

Okay. No. In terms of interest rate sensitivity, there's no big difference compared to what we talked about beginning of March. So, the way I phrased it, and which was maybe somewhat controversial or not fully understandable. I'm not sure. But I said that assuming a steady balance sheet year-end last year and the expected yield curve, the NII change would be around 13% in the euro and HUF volumes. So that was the sensitivity to the expected changes in the rate environment.

Now, if we talk about deviations from this. So, what happens if the rate environment doesn't change in line with expectations, but it's either more or less than the sensitivity, again, as I said, in HUF terms, it's quite low. 1 percentage point difference compared to what expected is would not have a material impact on a group level, really. The euro sensitivity is quite stronger. 1 percentage point is pretty equals to EUR 140 million annual NII for the whole group. That's all the euro interest rate position across the group. Now that decline, it used to be EUR 160 million and EUR 180 million during the course of last year. That's due to the fact that we are buying fixed assets securities, primarily, and we buy some IRSs. So we are gradually reducing this euro rate sensitivity, and it has come down from a EUR 180 million, EUR 190 million mid last year to EUR 140 million annual NII impact by 1 percentage point.

OPEX in Bulgaria we had this HUF 11 billion one-off costs which we had to book in the first quarter. That's the deposit insurance contribution. Therefore, the cost-to-income ratio went up to 41%, but the run rate last year was 31%. We actually in Bulgaria, we are running on low 30s cost-to-income ratio, which in my world, that's a good number. I think that we can be rather satisfied with that, especially if we compare to the enormous transformation work that we are doing in Bulgaria. It's not yet that visible, but that bank is changing extremely fast. I think pretty soon, we will come out to the market with all the new developments. Internally, it's already a quite different bank than a few years ago. That was driven by the merger with SocGen, which is a very different culture, I would say, from DSK Bank and really infused our organization with a fresh and new dynamic energy. Plus, we have a new CEO there since the end of 2020. So, these together, I think, would be back in a very swift modernization path.

Again Slovenia, the first quarter was 45%, but last year, we were at 37% in terms of cost-to-income. That's more the run rate. I think that's a reasonable level. In Slovenia, we are still in the process of the merger. We expect to finish the merger most probably end of summer, September. Then cost synergies will be realized after the merger. If anything, we expect improvement in the cost-to-income ratio in Slovenia.

In Croatia, 48% y-o-y improvement. Serbia 37% y-o-y improvement, last year, first quarter was 40%. Serbia, like 5, 6 years ago, it was at 70%, 80% cost-to-income ratio. This is the country where we improve most in terms of cost efficiency. That's obviously due to scale economies and the synergies we realized through the 2 mergers and 2 acquisitions that we have done recently. I could go on because also the smaller banks rather well, right? Montenegro 39%, Albania 42%. These are recent numbers, right? I mean, okay, more than decline because the margin went down. The net interest margin, I explained how much the rate environment declined and a strong decline in margins. So that's not cost increase. That's just revenue decline due to external rate environment impact. Then we have like Ukraine 30%, Uzbekistan 32% cost-to-income ratio. I don't see, to be honest, problems in terms of efficiency. If anything, we are improving gradually. The only country which is in a way outlier is Hungary, right? Because in Hungary, we have a higher cost-to-income ratio, it's improving but still higher. But to be frank, the Hungarian operation, especially the net interest margin and the cost-to-income ratio, this cannot be compared to the other group members where we have, and this can also not be compared to other banks in

Hungary, for instance, because this entity OTP Core is on one side is the Hungarian banking activity, but on the other side, this is the kind of holding entity as well, and these 2 functions are merged into this on Core. In terms of investments into subsidiaries, it's almost HUF 2 trillion, which sits there in the Hungarian balance sheet, and these assets are not interest bearing. We have like HUF 2 trillion, HUF 2.5 trillion equivalent group liquidity pooling going on, which we, again, there's a very small margin on that. Then there are all the additional MREL and other capital elements, which we had to issue, which are very expensive, and we are also sitting in the Hungarian balance sheet. Plus, we have the cost of actually managing the group, which is part of the operational cost of the Hungarian entity.

We don't want to confuse you with another adjusted core number, right? We are not presenting these numbers, but we obviously run internal calculations to quantify the impact of OTP Hungary being also the group holding entity. If we were to separate the impact of being the holding entity of the group, and if we were to only look at the Hungarian activities as related to Hungary, then the net interest margin in the first quarter would have been 4.1% as opposed to the 2.75%, which we actually report. The cost-to-income ratio would have been 43% as opposed to the 52% what we report. So again, I think if you look at the cost-to-income ratios across the group, outside Hungary, I think they are rather okay, and if we look at Hungary, this 52%, it looks high compared to some other banks in Hungary and also compared to our own group members. But if you adjust with the impact of Hungary also being a holding centre, then we go down to 43%, which is in the middle of the group in terms of cost efficiency.

Acquisitions and what is the lowest common equity Tier 1 level where we are still comfortable. Okay. After the first quarter last year, we were at 14.3%, if I remember, 14.5% somewhere there. That was because we just finished our largest ever acquisition in Slovenia. Now unfortunately, that was the time when small financial crisis started to boil. That's when we had the Silicon Valley Bank. That's where we had in the U.S. and some other banks, and that's when Credit Suisse went down. We were still okay. But firstly, I didn't feel that comfortable to say that. Luckily, there was no global financial crisis, but we were about to buy Ipoteka, and we were 14.3% common equity Tier 1. If a global financial crisis started on that day, really, then we would be still quite okay. But then we would have been on a lower end of our comfort range, put it this way. So that's the factual evidence, right? I mean, in terms of our comfort level. The problem is with common equity Tier 1 ratios is that it's always relative, right? Fundamentally, these numbers unfortunately don't mean much, right? There's very little scientific evidence about this 8%, right, which was just decided 40 years ago, a 35 years ago, somewhere. Therefore, the whole intrinsically, this ratio doesn't tell much. Does tell a lot in terms of the capital, in terms of the requirements, so compared to the capital requirements. So, I think if we are at 14%, 15%, we are still well, well above capital requirements in terms of common equity Tier 1. However, if you look at other banks, which is the other potential measurement angle because we are compared to other banks, then it's common equity Tier 1 was still okay, but we don't have alternative Tier 1, so 14%, 15% alternative Tier 1 is a lot rather lower number in Europe. We do want to be considered as well capitalized, right? That's a conundrum, and it's a problem that with all the banks, there seem to be a crazy competition who's going higher with capital adequacy ratios. To be honest, I don't understand this, but we are clearly not big enough in Europe to be a leading voice. We have to adjust to this environment. We would like to appear as well capitalized compared to other banks in Europe. That means that, unfortunately, we have to have much more capital buffer about the minimum requirements than we would normally want it to. I don't know what to do about this. I think this is a general problem in Europe that banks are growing higher and higher, partially, obviously, it's driven by the expectations by the supervisor, and part of these expectations are not even visible. I think this is a strong contributor of Europe not being competitive in inventions, market behaviour, efficiency and so on and so on. So that I think it has a huge negative impact on the overall competitiveness of Europe, if the banking sector is served risk-averse runs in such a high equity base and so much risk averse. I'm afraid of this is not the optimum for the European societies and the economists, but I don't think we can do much about that. Sorry for rambling around this, but I feel personally concerned about this. So, a long answer to a short question. Sorry.

Máté Nemes – UBS

That's been very helpful. I appreciate the views.

Operator

The next question is from Gábor Kemény, Autonomous Research.

Gábor Kemény – Autonomous Research

Just to continue on this topic, perhaps. What is your thinking about issuing AT1 capital to diversify your capital structure? And then maybe raising he capital planning, capital question a little bit differently, how high capital ratios would you tolerate? I mean, there must be a level where you feel that it might be impacting your ROE too much.

Another question would be on deploying your capital. I mean, what is your current thinking here? I think the CEO talked about an autumn decision on this deal. If it does not happen, what ways would you see to deploy capital from here? So that is on capital and capital return.

And then another question, please, on loan growth. Can you comment on the pipeline? How does the pipeline look go into the second quarter now? I mean, just doing, how you performed in 1Q and last year in 1Q, it's hard to see how you will not get to the double digits in terms of loan growth this year. But what any colour would be welcome.

László Bencsik – Chief Financial and Strategic Officer

AT1, indeed, it's all Western European banks use this, none of these Eastern European banks use this. It is expensive. I think there's an additional premium put on potential Eastern European issuers. Last year was difficult for this instrument. Currently, the market is really good it seems. We are open to this. If we can make this certainly cheaper than cost of equity, but more expensive than what we would love of pay as an interest for an instrument like this. If you see a good use of the additional equity, then yes, we will issue. At the moment, we don't. I don't think we change our strategy so far that we only wanted to use this if there were a strong, clear usage of that net capital.

In terms of acquisitions and the capital deployment. Indeed, our Chairman and CEO, talk about this opportunity, the opportunity is there. I think he has told everything. I don't everything what we're willing to share. On this specific deal, I don't have anything more to say. More on a strategic level, we remain growth oriented. First thing is just stability, right? The conservative foundations in terms of capital, liquidity, provisioning and returns, provisioning margins and returns. Then we want to capture every potential opportunity, which creates shareholder value to grow organically and inorganically. We have been doing this for a long time, and especially I think the last 7, 8 years has been particularly successful in doing this. We don't want to give this up. We continue to look for opportunities, and now we have an opportunity here. We want to create shareholder value. It's much easier to explain to ourselves that we create shareholder way if we buy something in a country where we have already a presence because then there's a cost synergy or if we enter a new market, which is in a very early stage of banking sector development and therefore, provides a huge growth opportunity like our last acquisition was in Uzbekistan last year. That doesn't mean that we are not open to buying assets in more developed countries, but they have to come at a very convincing price. I think it's down to price, right? If the price is at a given price, we believe that we clearly create shareholder value, then we are happy to consider. This is the situation where we are. But this is just one opportunity. We continue to look for others. There will be, I believe, other potentials during the course of the year, which we will get engaged in order to explore them.

Loan growth expectations and guidance, as I said, we decided not to change the guidance that we made at the beginning of March. In terms of loan growth, FX-adjusted organic performing loan growth volume may be higher than in 2023, where we had 6%. Now the first quarter, as we looked at it, was without Romania and rounded up 2%, including Romania and rounded down to 1%, around 1.5%, which in terms of retail was a very strong start of the year, as I explained. In terms of corporate, there was actually a very weak start of the year, not due to our efforts but due to the market environment. I think if we are right and the second half of the year, we'll be much stronger in corporate loan demand. If this retail demand growth continues over the course of the year, which we expect to do, then it might be visibly more than last year's 6%. That potentially is there. I think we will know more when we talk about the first half numbers in August.

Operator

The next question is from an attendee joined via phone.

Robert Brzoza – PKO

This is Robert Brzoza from PKO BP Securities. I hope you can hear me. First of all, I have one quick question on regarding the fair value adjustments, which was the issue which was raised during the presentation. I did understand this HUF 80 billion plus positive impact is mostly coming from the compression of government bond yields on the local market. Hence, I got a little bit surprised by the outlook implying that there would be no longer be during 2024 another, at least, partial repeat of this positive impact, which we had seen in 2023. So, my question is, is this not that much dependent on the compression of the bond yields? Are there other factors at play, for example, you're not expecting the bond yields in Hungary to drop that much as they did during 2023?

László Bencsik – Chief Financial and Strategic Officer

It's actually complicated because these subsidized structures are fixed for 5 years and then they repriced in every 5 years. It's such as the overall level of the yield curve, it's also the shape of the yield currently and the change of the shape of the yield curve, which matters. The closer we get to the next repricing event; the fair value is affected by the change in the yield curve as the longer end change in the yield curve and less by the short term.

For instance, compared to the end of last year, the long end increased, the short end decreased in HUF, right? That overall, on the whole portfolio resulted in a small negative number. I'm not sure, is it clear?

Robert Brzoza – PKO

Yes, I'm here. I'm just considering your answer.

László Bencsik – Chief Financial and Strategic Officer

The entire yield curve shifted downwards, and that had a positive fair value adjustment. The value the mark-to-market value of this cash flow has increased. But what happened during the first quarter compared to the year-end in the half yield curve, but the long end went up and the short end went down.

Robert Brzoza – PKO

Right. So, in other words, you expect this sort of behaviour to persist during the year, not much of a compression on the long end of the curve. That's my understanding if I'm correct.

László Bencsik – Chief Financial and Strategic Officer

There will be each quarter, there will be some amount, right, plus or minus, depending on when it happens, the magnitude and the changes in the shape of the yield curve. Even the inflection it is a quite big portfolio, and it has been generated over a couple of years. The repricing is at different stages with different structures. It is actually a pretty robust calculation, what comes on this. One thing is sure, unless there's a similar to last year, magnitude of downward shift of the entire parallel shift of the whole yield curve, which is very unlikely. Then we are not going to see the same levels of positives, what we had last year. In each quarter, there will be some plus or minus maybe, but we don't expect this to be very material for the overall result. Last year was really exceptional in that. It was quite material.

Robert Brzoza – PKO

Right. Got it. If I may have one more this time on the resets related to the subsidized portfolio, which would be beginning particularly in the baby loan segment, would you have any rough estimate of how much over the entire year that could support the Hungary core NII?

László Bencsik – Chief Financial and Strategic Officer

Yes. That's included in our NII expectations.

Robert Brzoza – PKO

Right. Okay. And maybe last one, given that the cap on corporate deposits expired, would you be expecting now the yield on the average rate offered to migrate upwards to become closer to the level of the domestic interbank rates perhaps starting from the second Q now?

László Bencsik – Chief Financial and Strategic Officer

Yes. That has a small negative impact on our expected NII.

Operator

The next question is from the analyst of Goldman Sachs, Mikhail Butkov.

Mikhail Butkov – Goldman Sachs

I have a couple of questions. The first one is on Uzbekistan. I think that during the AGM and some articles referenced the comment with regards to Uzbekistan and the return on invested capital. So, could you please maybe give a bit more colour how do you define it on your way is that equity plus some provisions? Or any colour around that? And maybe more broadly, what returns do you see in that segment?

The second question is just if you could clarify once again for net interest margin, the sensitivity to the euro was clear. But in Hungary, what are the remaining moving parts which may determine the next few quarters and maybe beyond that, the development of net interest margin in Hungary?

Lastly, on OTP Factoring recoveries. So, what is the balance of those receivables may be managed by OTP Factoring? Is that basically the Stage 3 loans? Or it is a broader definition or a different definition?

László Bencsik – Chief Financial and Strategic Officer

Uzbekistan, if you look at the first quarter number, the return on equity in the first quarter was 29%. We brought this bank at 0.5 book. And then the question is what you do with the unexpected losses that we had during the second half of the year due to the low global cotton prices, we quit the very cold winter and very bad harvest and the death of the fish in the fisheries due to not having gas during that call winter. And then I don't know how you want to treat that. But basically, you say that we brought this bank at 0.5 book and now it's making 29% on book, then, I mean, investment could be kind of 50% return on investment first quarter. Was it your question?

Mikhail Butkov – Goldman Sachs

Well, yes, more or less, I think that there was some range referenced in some press articles. But yes, I think that.

László Bencsik – Chief Financial and Strategic Officer

What was the finish?

Mikhail Butkov – Goldman Sachs

I think 25% to 30%, what was mentioned on invested capital.

László Bencsik – Chief Financial and Strategic Officer

We seem to be better than that already.

Mikhail Butkov – Goldman Sachs

Okay. Then that is clear.

László Bencsik – Chief Financial and Strategic Officer

NII development in Hungary. I told last year that on a yearly basis, we expected with assuming a static balance sheet of year-end last year. No growth over the course of this year. We expected roughly 30, a bit higher than 30% improvement in NII y-o-y in HUF. Now that's not the same as the Hungarian NII because part of the Hungary NII is not HUF related but euro and other currencies. Just taking the sensitivity to the HUF and the HUF NII y-o-y like 30%, something higher than that growth. That hasn't changed much. The fact that we seem to operate on a somewhat higher rate expectation now than what the plan was based on doesn't have a really material difference compared to that expectation.

That's why I said that our in this range, in this between 6% and 8% rate environment, in that ballpark, we don't have much interest rate sensitivity. We are in a rather neutral position. If you just look at the of nominal NII growth y-o-y, first quarter this year over first quarter last year, then it was 53%. Overall, Hungarian NII went up by 53% compared to the first quarter last year. Now it's not going to this yearly difference will be less and less, obviously, as the NIM, the net interest margin improved a lot last year. But I think it's a good start of the year.

Factoring recovery, yes, basically, we sell to our Factoring units in Hungary, all the nonperforming loans. All the Stage 3 loans are there, especially retail, so that's the normal procedure we have been doing this for 20 years. Typically, we have a higher recovery than the original level of provisioning. And that's their target to achieve that. And that reduces the risk cost.

Operator

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

Laszlo Bencsik – Chief Financial and Strategic Officer

Thank you. Thank you very much for joining us today and thank you for your very good questions. I wish you all the best, good health, good first part of the summer, and we come back early August. I think, on the 9th of August, we plan to have the next quarterly report, and I hope you will join us then as well. Till then, all the best and goodbye.

Operator

Thank you for your participation. The first quarter 2024 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.