Strategy and Finance Division

Investor Relations & DCM

OTP BANK
4Q 2022 Conference call
Transcript

10 March 2023

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

Operator

Dear, ladies and gentlemen, welcome to the OTP Bank Fourth Quarter and Full-Year 2022 Conference Call. This conference will be recorded.

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

László Bencsik – Chief Financial and Strategic Officer

Thank you. Good morning or good afternoon, depending where you are and thank you for joining us today on OTP's Group 4Q 2022 conference call. Special thanks to join us when markets are in such a turbulent mood, certainly yesterday was quite a difficult day for banking stocks, especially in the U.S. So, special thanks that in this situation, you devote your time to us and listen to this conference call.

As usual, we have this presentation which is available on the website, and we are sharing with you on this video conference. I'm going to go through the slides and then we'll have a Q&A session. Page 2, you see the annual results and the quarterly results. Overall, profit after tax, the bottom line dropped 24% compared to 2021 and that drop was driven by a large amount of adjustment.

So, '22 was unfortunately again a year where we had a long list of negative adjustments, and you can see that on this page. The biggest one was the bank tax and the extra profit tax in Hungary, imposed by Hungarian government. The other Hungary related bigger hit was the interest rate cap on variable mortgages and variable SME assets.

Other than that, we had directly related one-offs to the Russian-Ukrainian war, namely, we had to make goodwill impairments related to our investments, especially in Russia on our sovereign bond exposure, we created a sizable provisioning. In 4Q, we had some one-offs, one was HUF 26 billion, which was the extension of the interest rate cap for another six months till the end of June this year. And the inclusion of the SME loans. And you can see a HUF 3.2 billion special tax on financial institutions. This is related to Croatia, that introduced an extra profit tax, which is not specific to banks. It covers all mid and large corporates, and this is the amount we booked there.

Without these adjustments, profit after tax increased 19%, including Russia and Ukraine. Looking at the quarterly profit, there were somewhat less adjustments. Nevertheless, the adjusted profit dropped, as well 19%.

On Page 3, you can see more detailed P&L numbers and they pretty much explain this quarterly decline in earnings on a group level. While income was relatively flat, last year, we had some seasonality in operating costs and in risk cost, as well. Operating expenses were higher and total risk cost was somewhat higher, revenues were flat and that resulted in a somewhat lower profit level.

If we look at the ratios, again, the entire group adjusted ROE was close to 19%, the unadjusted profit after tax related ROE was 11%. Margin was flat year-on-year and even within the quarters there was quite a small difference last year. As you can see, net interest margin was rather flat on q-o-q basis across the group. Cost efficiency improved despite high inflation and the risk cost ratio increased, and that is entirely due to Russia and Ukraine. In the coming pages, you can see the performance without Russia and Ukraine. As you can see, overall, the two countries had a positive contribution, especially in Hungarian forint terms. I will explain it later. The Russian operation in ruble terms suffered more than 50% decline in profitability, in HUF terms there is an improvement, but maybe we go back to the previous page, just for a few words.

Our original guidance was based on this view of the group without Russia and Ukraine. The war started in February last year and we made the guidance early March. At that time, we had very little clarity on the potential impact of the war, direct impact in Russia and Ukraine, therefore we phrased our expectations without Russia and Ukraine and the expectations, which we modified during the year, the latest versions were 15% performing loan growth, that we achieved, improving adjusted ROE that improved year-on-year. Net interest margin was stable. There was a 4 basis points decline, so close to stable, improving cost income, I mean, cost efficiency improved and we suggested similar to '21 risk profile, but actually that was better. So overall, without Russia and Ukraine, risk cost was quite small.

A bit more detail on Russia and Ukraine. In Russia, after the war we changed the course of the bank. We adjusted the strategy. We pretty much stopped entirely the corporate lending. As you can see, corporate loans, which were by the way, even at the beginning of the year a rather small portion of the portfolio, declined by 75%. The

total loan book declined by 12% and deposits increased by 19%. Profit in ruble terms declined by 57%, so it was less than half of the '21 profits.

In HUF terms, it's a different picture because we had losses in the first half of the year when the ruble was weak, and we had positive results in the second half of the year when the ruble was strong. In HUF denomination, we see some year-on-year improvement, but the underlying profitability in local currency declined substantially.

Now, a few more important notes here. We managed to repay the funding or get back the funding, what we had outstanding to the Russian entity. RUB 11 billion was paid back by the Russian bank to OTP Hungary, so the group funding today is zero. We still have a sub-debt outstanding, which has a longer maturity. You can see on this slide the capital: we have RUB 60 billion capital in our Russian entity, almost half of it is above the regulatory requirements. That means that only half of that is needed for the operations. Obviously, the mid-to long-term target is to transfer some of this equity to the group. The potential impact of writing off the entire operation in Russia declined a lot in line with reduced level of group funding, so now it's just 71 bps at year-end.

In Ukraine, the profit was negative, we made losses. However, if you compare the magnitude, the severity, and the drama of the situation in Ukraine to the level of the financial loss that we incurred, I think the loss is relatively moderate and that reflects the resilience of the operation and the loan book what we built over the last couple of years. This is not shockproof, but at least quite a resilient bank now. And I think this is very clear in the numbers. Last year we tripled the provision levels. Total provision coverage on gross loans, so Stage 1, 2, 3 together is 22%. It's 3x increase during last year and is close to 22% coverage.

Our expectation is that this is going to grow higher than 30% during this year, while we keep making profits in Ukraine. There is a decline in portfolio volumes coming from subdued lending activity, deposits increased, and we kept all the outstanding group funding in Ukraine. We continue to support Ukraine as much as we can through every means. Equity somewhat declined due to the provisioning. Nevertheless, we are far above the regulatory requirements. The potential worst-case scenario of writing off the bank, which we don't sign any material probability to, is very low, it's like 1 basis point.

This was a heroic year for our colleagues, and I try to use every opportunity to thank all our colleagues there and to all our clients who stayed by us. Our colleagues did everything in Ukraine to provide high level of banking services despite a very difficult operating situation in the country and we will continue to do that in the future.

Page 7: the good news is that, if you look around in the countries, other than Russia, Ukraine, the performances have been quite spectacular, almost everywhere we had improvement in profit, in profitability with decent growth rates. In Bulgaria, we had 56% increase in profits, Croatia 30%, Serbia 15%, Slovenia 41%, Albania 66%, Montenegro 2.5x higher profits, a 50% increase in Moldova with not an easy economic and geopolitical situation there. But even in this environment, we managed to increase our profits and its only Romania, where there's no visible improvement yet but we are quite hopeful that this year's performance will be much better and the efforts over the last couple of years to increase the size of the bank will bear fruits soon.

So overall, very strong performance in the CEE countries. Obviously, that contributed very positively last year to the overall group performance. The reason that the total bottom line profit only declined by 24% year-on-year is due to the very good performance of these countries. This very good performance is somewhat counterbalanced by the huge negative one-offs we had to suffer in Hungary.

There's a very recent positive event in the group. Finally, after a very, very long process, we received the approval of the Slovenian competition authorities to buy the bank. It was a long, but very thorough process and now at least we can be sure there's no issue left to open. On 6th of February we closed the transaction. When we report the 1Q results, you will already see the NKBM Bank being included in the consolidated group, the February P&L results, and the one-off positive impact.

We estimate the one-off positive impact to be around EUR 230 million after tax, so that's a potential one-off positive, which is very similar to the amount that we have to book in 1Q related to the Hungarian bank tax and the Hungarian extra profit tax. Both of these one-off items will be booked in 1Q, and they seem to be quite close to each other and cancel each other out almost entirely.

NKBM is a very good quality asset, what we managed to acquire, and we are extremely happy. It is a very well managed bank with exceptionally good client base and profit generating potential. We are very excited. We have already started working on the merger with full effort, we are doing the detailed planning of the process and we are going to go through the normal, for us quite well-known process of merging banks. It will probably take 15 to18 months to complete the legal and operational and IT merge. It's expected to happen somewhere mid-next year.

By assets, we are going to be #2 and by net loans #1 in Slovenia. In the meantime, NLB acquired the remaining part of the Sberbank Group in Slovenia. They are growing through an acquisition. If we present the pro forma numbers here by total assets, they are going to be or continue to be a number #1 rather.

Looking at the last six years, we have been extremely active in acquisitions and in fact, for the whole group, net low volumes grew 3.4x. It has been an extraordinary strong growth period for us. Organic growth was on average above 15%. On top of that, we were growing through acquisitions. The average CAGR of customer loans for the last six year was 25%, including acquisitions and 15% without acquisitions, organic only growth. If you compare this to the other regionally active banking groups, even the organic growth part is probably twice,3 or 4x bigger than what they had as growth rate.

This fast growth changed the group structure. As you can see on this slide, the share of the Hungarian business declined. You can see pro forma numbers including NKBM and including Ipoteka Bank, the Uzbek bank where we expect to close the transaction in 2Q this year. So pro forma, including these two banks, by year-end '22, the share of the Hungarian business in terms of net customer loans went down to around 30%.

The share of the Eurozone and ERM II countries increased to more than 40%, and that's a land slide change. In fact, the 6%, which we used to have in 2016 was related to Slovakia and we sold Slovakia. We got to 41% despite selling the 6% what we used to have. This is due to Croatia joining the Eurozone in January this year and our first acquisition in Slovenia, SKB from SocGen and our second recent acquisition in Slovenia, NKBM, plus Bulgaria, which is in ERM II and it was meant originally to join the Eurozone beginning of next year, but they postponed this date due to not meeting the Maastricht inflation criteria. We expect this problem to be overcome soon, as early as '26, but very likely '27, we hope they will join eventually the Eurozone and then they will be able to benefit from the Eurozone's benefits, not just complying with all the requirements. The share of our Russian and Ukrainian portfolios declined by half. It used to be 10% of the group in '16, today it's only 5%.

These are quite big structural changes. This matters from the risk profile point of view, a lot that the organic Eurozone or quasi-Eurozone countries' share increased drastically. There's another positive effect here: recently the Eurozone rate environment has increased. These operations benefit from higher rates, higher euro rate, so that's an additional bonus on this one.

Maybe a few words about the net interest income because I'm sure you have noticed the quite big drop in OTP Core in Hungary. Despite q-o-q 2% increase on consolidated level in net interest income, in Hungary we had 20% decline and that certainly requires some explanation. The net interest margin was quite stable up until the end of the second quarter last year. In '21, it was 2.85%, in '22 1Q, it was 2.76%, in 2Q it was 2.84%, but that has started to decline. Third quarter was 2.61% and in 4Q 2.11%. During the second half of last year, starting somewhere in July, the Hungarian rate environment started to diverge substantially from the surrounding countries. Around June, July, we had 7%, 7.5% base rate. Then starting a rather steep and abrupt increase, we ended the year with 18%, so by more than 10 percentage points higher.

The big hike was in mid-October. In three months, the rate environment increased more than 10 pps. At the same time, the mandatory reserves requirements increased from 2% to 5%. The Central Bank only pays 13% on these reserves and we lose 5% or we lost 5% starting from October last year.

Plus, we have this repricing pace difference. When rates are growing so fast, corporate deposits reprice almost immediately, very rapidly. However, corporate loans, pretty much the only variable assets what we have, reprice with a three to six months' time lag according to their own repricing schedule. So that created a temporary drop in NII, just because of the time difference of corporate loan and deposit repricing. This alone had a HUF 6 billion negative impact during 4Q, but this is temporary, so this is going to come back and improve from 1Q.

This big decline is partially explained by this temporarily situation and is going to be here in 1Q, but most of this decline is more structural and related to the higher reserve requirements and the fixed asset surplus in our asset liability balance. We are losing when the rate increases, and we are gaining when the rate goes down.

The current point sensitivity to the rate is roughly HUF 15 billion, 1 pp annualized. So that's a difference between an 18% and the 13% rate ceteris paribus in Hungary, it's roughly HUF 15 billion annual NII difference. We are very sensitive to the rate environment. Obviously, when the rate increased, we experienced a negative impact and whilst the rates will go down, we will experience a positive effect, in fact, everything else being equal.

Now the problem is that not everything else is equal, since recently the Central Bank announced the increase of the reserve requirement from 5% to 10%, plus we are not going receive anything for 2.5%. The effective rate of the reserves assuming 13% base rate is 9.75%. This is obviously negative for us. Even if rates moderate, these two negative factors, namely the increase in the reserve requirements and the lower effective rate that we received on the reserves are going to have a negative impact in 2Q.

The big question of this year is, which one is going to be bigger and how fast the rate decline will be in Hungary because if it's very fast and it can, in a way, counterbalance this negative impact to a great extent. But if rates of 18% rate level continues for a longer period, then that's going to put additional pressure on our Hungarian NII. Our expectation is that rates will moderate, and that moderation will start soon. Obviously, this is related to inflation.

Now the Hungarian inflation, stays unfortunately on quite high levels, much higher than in the neighboring countries. The peak was at 25.7% in January. The good news is that the February data, which came out recently is already lower, 25.4%, which is a small improvement, but at least it shows that, hopefully, we are over the inflection point. Most importantly, the monthly repricing dropped from the previous 2-plus percent down to 1.3% in February.

I think we have every reason to expect a rather swift moderation of the inflation in Hungary. We already see food prices dropping, well, in general, consumption dropped, and retail trade dropped year-on-year by 5%. The exchange rate appreciated compared to the weakest points last year around by around 24-25%. The last week, we had EUR/HUF of 370, 380 levels, that's another strong boost to inflation decline.

Most importantly, energy prices and specifically gas prices on the European market dropped more than 85% compared to the peak last year, which again is going to have a positive impact on inflation in Hungary and not just on inflation, but very importantly on the current account balance, which we expect to be only 3%, maybe 4% this year, which is pretty much a manageable level.

So therefore, this longer deliberation on this point, but probably this is the most visible or important event or number in the 4Q and I'm sure you had couple of questions in your mind related to this that's why we spend some more time explaining this.

Other than that, all the other countries are better, and all the other countries improved in Hungarian forint terms, especially. But even in local currency there was more than enough improvement to counterbalance this negative impact. In fact, q-o-q, we had a 2% increase in NII on group level. It was only Hungary that went down.

Margin on Page 12, again not surprisingly: Hungary was negative after this story, which I just explained, and all the other countries were positive. On group level, it was almost flat. It's the same story for the underlying difference. Then volume dynamics changed drastically in 4Q across all the countries where we operate, except Russia, where we had an increase in 4Q, that's the usual seasonality in consumer lending. But all the other countries slowed down and it's not just our numbers, but in case of Slovenia, Serbia, the market was contracting in terms of loan volumes. We see a quite rapid reaction by loan demand and loan supply in most of the countries in this higher inflation and higher rate environment: loan growth moderated quite rapidly. We had only 1% FX-adjusted loan growth across the group.

In Hungary, you can already see that mortgage loans were negative, and I think this is something, again, not very surprising that in this very high-rate environment, mortgages which are in local currency are quite slow and there's very, very moderate demand in that.

Now if you look at the whole year, the picture looks much better. On group level, we had 12% growth. If we exclude Russia and Ukraine, which was negative - you see in Ukraine -27%, in Russia -16% -, then I think these are strong numbers, especially Croatia 19%, Hungary 15%, Bulgaria 16%. It's important to note and draw your attention to the corporate growth. Corporate was exceptionally strong in most of the countries. Again, it was more of a one-off in the third quarter when inflation went up and corporates started to increase their inventory levels and that resulted in much bigger working capital loan demand.

Deposits, in the last quarter, we had 2% growth, and this was not uniform in the group, we had quite strong deposit growth in all the countries except Hungary, where it was negative. What happened in Hungary was that 25% inflation reduced savings. Retail savings started to decline, retail clients started to use their savings to smooth their consumption and somewhat counterbalance the negative impact of inflation on their living standards or spending profile.

It hasn't happened for a very long time that there is a negative retail deposit growth in Hungary, but it did happen last year. In fact, last quarter, sorry, because the whole year was still overall positive. I think it's important to note here that while volumes declined, our market share from household deposits increased. During the whole year, it increased from 37.8% to 39.3%. During the last quarter, 4Q last year, it increased by 20 bps.

The market declined more than we did. Overall, retail deposits declined and the decline in case of OTP was less than what the market suffered. One thing is that people with more saving try to compensate for higher inflation impact on their spending profile. We have the retail sovereign bonds at a rate which are inflation indexed or

adjusted, so this is obviously very, very difficult to compete against with bank deposits. People reallocated their savings more to sovereign papers than to bank deposit.

But overall, if we look at the whole year, Hungary was 9% positive, or the group was 14% positive. Our net loan-to-deposit ratio remained flat at 74%. The liquidity situation of the group did not change.

Fee income, I don't think there's so much to deliberate here. Other income: the only q-o-q difference is coming from the one-offs in the third quarter. We had big gains on selling some of the private equity fund investments. There was a big result there in the third quarter and that did not repeat itself in 4Q. So that's more a base effect, I mean the q-o-q decline. And then maybe cost is something where we might spend some more time. It's a high inflation environment everywhere where we operate, especially in Hungary. And it's not just high inflation, but the currency weakening, and we have many of our IT services and contracts in local currencies.

In Hungary, you see a 19%, quite high increase in costs, but it’s not personnel expenses. Personnel expenses grew 10%, amortization increased 10% and this excessive high growth came from other costs, namely utility costs, a huge increase in supervisory fees, weaker currency which translated into higher IT service costs in local currency, and much higher real estate cost because we opened a new headquarter building. We are in the process of consolidating the office space what we have in Hungary. For a limited period, that means that we're running much bigger office capacities than needed.

In terms of capital and liquidity, given the events of yesterday and maybe today on the global banking markets, it probably deserves somewhat more detail than usual. Our liquidity position continues to be stable and robust. The net loan-to-deposit ratio on the group level is 74%. In fact, y-o-y it declined somewhat. It means that we have 1/4 more deposits than loans. There's a big deposit surplus in the group, especially in Hungary, where the ratio is below 55%. In Hungary we are even more liquid than on a group level in terms of the loan-to-deposit gap.

The LCR ratio, the liquidity coverage ratio, which is the European standard for measuring short-term liquidity position, is 172%, 100% is the minimum. We are way above that. In nominal terms, it means that we have almost EUR 8 billion above the LCR liquidity coverage ratio minimum and our high-quality liquid asset portfolio is more than EUR 18 billion equivalent, and this is at market value. All these numbers are calculated on the repoable basis of securities. So that's after adjusted to market value. It has been quite stable for several years. Plus, we don't have major external maturities. I mean, we issued couple of bonds recently to fulfil the MREL requirements. As you can see, even this year, 1Q, we did it a Tier 2. Then last quarter, 4Q last year, we issued a senior preferred in value of USD 650 million.

We are quite active to reach the MREL targets, which kick in from January next year. We are going to continue our activity on the DCM market. We plan to do another two or three benchmark size deals, at least EUR 500 million during this year to get to this required level of MREL funds available on a group level.

The next page is about the coverage ratios, there's not much happening there. I mean the group level Stage 3 ratio declined below 5%. So, for some reason, this seems to be an important level. I think it's well as symbolic. But anyway, we drop below that on a group level, including Russia and Ukraine. Without Russia and Ukraine, we are down to 4.1% on the group level and there will be a further drop once we include NKBM in the portfolio in 1Q. We are getting closer and closer to low NPL levels overall, while we keep the coverage somewhat more conservative than some of our regional competitors.

A few detailed information about Hungarian business. In general, we see a very strong slowdown in mortgage lending. In fact, consumer loan activity in Hungary slowed down, but not as much as mortgage lending. It seems that mortgage lending is not very attractive at these rate levels. In consumer loans, there's some decline, but not drastic and we remain very active in selling the subsidized structures. If you go to the next page, you can see that the most popular retail mortgage product was this green housing loan, which is a subsidized structure, and our market share was almost 60% from the disbursement of this type of loan last year.

In corporate, again, we remained quite active last year, up until the end of 4Q. It slowed down, but over the whole year, we had 33% growth in performing corporate volumes in Hungary. I think this is highest ever annual growth rate and our market share increased accordingly. We had 20% and again, we were last year extremely active in distributing the subsidized product, the Széchenyi Card Go! structure with 32% market share from this disbursement.

We continue to be very active on the ESG front. We laid down the strategy, set up the organization and allocated strong resources. Now we're starting to see the results and they seem to be more and more measurable. We set up a green loan framework, a sustainable finance framework. Green investments or green finance is quite active, and we have made substantial developments in our methodology to capture and measure ESG risks. That is reflected in the improvements on our sustainability ratings, as well. It is measurable and it's a group-wide effort.

We share best practices across the group and make every country focus strongly on ESG dimension, especially in CEE countries where we operate.

Now few words about expectations. Macro environment: we believe that despite previous fears, we don't see recession coming to Europe or to the countries where we operate. The only country where we expect negative GDP growth this year is Moldova. Even in Russia and Ukraine we expect positives, and even in Hungary, we have positive expectations. In other countries, there might be some slowdown compared to '22, but still okay growth levels. That's one important factor.

The other very important factor is inflation, especially in Hungary, where it reached extraordinarily high levels, even compared to the countries around us in the region. We have a very clear expectation that the moderation of inflation is going to be fast. By year-end, it's going to drop below 10%. We expect below 9% y-o-y inflation by the end of the year. That is crucially important for us. Every part of the economy should do much better in a more moderated inflationary environment. As I explained before, our earnings, our net interest income is very sensitive to rate levels We expect especially in the second half of the year a strong and fast decline in the rate environment from which we should benefit in terms of our NII in Hungary.

A few words about expectations. As usual, we'll try to carefully formulate these expectations. First, the war continues in Ukraine, and we are very hopeful that it ends soon and there will be a quick resolution and suffering will end. But we still don't see that happening and we don't know when it's going to happen and that poses a much higher than usual level of risk on all the operations that we have in Russia, Ukraine and outside of Russia, Ukraine. This is still a highly uncertain environment and situation. So please, take our guidance or our expectations in that context. There's a higher than usual uncertainty here.

Now with that remark, we don't expect deterioration in the operating environment of our banks in Russia and Ukraine. If they don't deteriorate, then in both countries we expect better performance financially than last year. And in Ukraine, that better performance, meaning positive result, should be coupled with a further steep increase of provision coverage on the entire loan portfolio.

Regarding Hungary, and again because of the rate sensitivity in Hungary and the size of the business in Hungary, it is potentially the most important factor for the whole group performance, how fast and how much the current 18% rate will moderate during the year. The faster the pace the better results there will be in Hungary. Certainly, according to market expectations, if you just take the implied rate levels in market instruments, then we should have an improvement compared to last year. If you take the 4Q 2022 level compared to that, we expect improvement in NIM and in NII over the course of this year. The lower the rates, the higher the improvement might be. But there’s a negative impact coming from the second quarter due to the recent increase of the mandatory reserve rate and the decrease of the interest on the reserve.

It's an unlikely scenario we believe, but it can happen that if the rate decrease is zero or rates even go up, then obviously, what we wrote here may not stand. Now, the one-offs in Hungary: we know that we are going to pay again this extra profit tax even though our profits, our after-tax profits in Hungary without dividends from group members dropped 84% year-on-year last year. Despite this, we will still pay HUF 69 billion extra profit tax this year plus the usual bank tax. This is all together HUF 88 billion profit after tax. These items we are going to be booked in 1Q.

The good news is on the next page. So, at least this extra tax one-off, which we book in 1Q, is expected to be balanced out by the one-off positive impact of consolidating NKBM in Slovenia as a badwill associated with this purchase price allocation, initial risk cost, so everything altogether adds up. It’s not a final number yet, but we are already quite progressed with the calculations. It was our auditor’s suggestion to announce that the expected impact will be around EUR 230 million after tax because it’s quite a substantial number and there’s already a high level of certainty that it is going to be booked indeed with this amount in 1Q.

It is important to make clear: this positive one-off effect will pretty much entirely counterbalance the negative one-off effect of booking the normal bank tax and extra profit bank tax in Hungary during 1Q this year.

Other than that, in terms of loan growth, we expect slowdown. That slowdown already happened during the 4Q last year. I don’t think there’s anything surprising there. Rate levels are higher, and in higher rate environment there is less loan demand, and we already started to see that last year. The expectation is that we are going to have probably low single digit, not more than 5% growth across the whole group in terms of performing loans. There will be certainly bigger differences between countries and bigger differences between portfolios than usual.

Net interest margin, again, with all the story behind it in Hungary, where it is the most uncertain. If you just take the market expectations regarding the Hungarian rate development, together with positive effects across the group, due to higher euro rate environment, we probably could end up on similar levels than last year. Portfolio quality levels seem to be stable. We don’t expect deterioration there, but we are facing strong cost inflation and

cost pressure. It might happen that our cost efficiency ratios may not improve this year. On the contrary, they might somewhat worsen. But again, we try to do everything to mitigate and minimize that factor.

All in all, adjusted ROE might be at a similar level than last year, around 18%. Now, and that is probably not surprising if the ratio, in the long run, goes like this. The big question is how much one-offs we are going to have or unforeseen one-offs because the foreseen one-offs again might be at a low level given that the big bank tax in Hungary is just about as much as the one-off positive from NKBM. We are not aware of any other big one-off items. If we close the Ipoteka transaction in 2Q, there may or may not be a positive one-off, we will see. We don't know whether the rate cap will be extended for the second half of the year. We don't know, probably it will. I must admit that it's quite probable that there will be an extension. But the big question is at what conditions, where the cap will be and most importantly, where the rate environment will be, because again, the lower the rate, the less we lose on these interest rate caps.

The expected level of dividends is HUF 300 per share. The Board of OTP will make a decision on 21st of March about the amount they propose to the general meeting, and it will be published on the 6th of April, but our preliminary assumption is that the proposal will be HUF 300 per share, and that's HUF 84 billion. I already mentioned that we plan to continue our issuances of market instruments to meet the MREL requirements by the beginning of next year. So that was the formal part of the presentation. Please, if you have questions, ask them.

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

Operator

The first question is from the analyst of Concorde Securities, Hai Thanh Le Phuong.

Hai Thanh Le Phuong – Concorde Securities

I have questions on 3 topics. The first one would be on your risk profile. You stated in your guidance, that you do not expect material deterioration under this line. So, shall I think about the cost of risk to be similar compared to the previous year? Because you said on group level, there shouldn't be any material change. But I was wondering, since from your talk, it seems that Russia and Ukraine should recover significantly, is there any segment that would counterbalance this positive improvement?

My second question would be on the cost efficiency. I know it's hard to say now. But with regards to cost income, do you have a number in mind, maybe should you stay below 50%? Or maybe we should think about even larger worsening of the cost-to-income ratio.

My last question would be on shareholder remuneration because HUF 300 is quite good per share. But I was wondering if you have considered or would you consider share buybacks besides or instead of dividends, maybe not this year, but maybe in the longer term.

László Bencsik – Chief Financial and Strategic Officer

Concerning risk profile, my comment was related to the whole group. Last year, the whole group risk cost rate was 73 bps. This was a result of a much higher level of risk cost rate in Russia and Ukraine and a positive risk cost rate on loans, at least for the rest of the group. There was a provision release overall. Provision for impairment and loan losses, as you can see on Page 4 of this presentation, outside Russia and Ukraine, was positive. On Page 4, you see plus HUF 7 billion. The '22 provision for impairment on loan losses was plus HUF 7 billion. On the previous page, you can see the overall, it was minus HUF 135 billion and the minus is coming from Russia, Ukraine.

The expectation is that in Russia, Ukraine, there will be less risk cost, but further as per the group, there will be more. That doesn't mean that we are going to see a worsening of portfolio. It was a special year for the rest of the group, because if you remember and I'm sure you do, in 2020, we created extra provisions During '20 and '21, we did not release these extra provisions, COVID-related provisions. COVID officially lasted until the war broke out in '22 February. We started to release part of this COVID-related extra provisioning which we created back in 2020 in 2022. We partially released them, partially we reallocated them to provisions related to the worsening economic situation and GDP trajectories across the group.

Part of these COVID-related extra provisions, which were created in 2020, we released or reallocated as a response to the worsening economic environment. The result of this was that the risk cost was positive outside Russia and Ukraine. This is not going to repeat this year. We just expect a normal level of risk costs in Russia and Ukraine. Then in Russia and Ukraine, we expect lower level of risk costs than in 2022. And these 2 effects may result overall in a similar level of group level risk cost what we have in '22, of 70 bps. At least that's our best estimate now.

We are trying to counterbalance the impact of the inflationary environment, and we are working hard to moderate that impact. I hope the cost-to-income worsening, if any, will be rather small. But we cannot deny that the situation is quite tight on that front, especially because labour markets remain strong. Unemployment is not growing, which is wonderful, right? From loan demand and loan quality point of view it means that high inflation is coupled with high nominal wage inflation as well. We don't want to lose good people. We are still focusing on organic and inorganic growth. I think the likely direction is probably up, but we hope to contain that growth as much as we can.

Regarding costs, I usually don't like to make forward-looking nominal expectations because it's better to show results on that front. But the pressure is there.

Buybacks, we would love to do with this level of share price. Now, the thing is that we are buying 2 big banks in 6 months, first half of this year. Our biggest ever acquisition we did in February, just last month in Slovenia. They are sizable tickets, right? And they do have an impact on our capital ratio. It's an unfortunate situation that this low share price and at least from our point of view, very attractive entry point potentially is coupled with a situation where we are just paying out the price of these banks.

We'd like to do buybacks, but due to the timing of the acquisitions, now we focus on paying for these banks, which will create, even more value than buying back shares. We are done and we accumulate some earnings, but probably by that time, the share price will be at a different level, at least, I hope. But if not yes, this will come. If not, then certainly, we will consider that.

Gábor Kemény – Autonomous Research

Yes. Thanks, Laszlo, for being upfront about the uncertainties in the environment. My question is around NII and deposits. Firstly, on the Central Bank reserve rules you pointed out. Would you be able to quantify the impact on your NII under your baseline rate trajectory in 1Q and 2Q? And then just on the broader NII outlook, would you be able to give us a steer for the next couple of quarters, what you expect? I understand Hungary, had faced some headwinds. And on the other hand, the rising euro rates, the uplift from the rising euro rates has been playing through nicely. Would you expect to be able to grow your NII or shall we expect stabilization in 1Q and 2Q? Finally, probably inevitable question today on deposits. Would you be able to comment on your liquidity situation in Hungary? I'm asking this in the context of you indicating a largely fixed rate asset structure in Hungary. I guess how far you would be comfortable with a declining trend in deposits there.

László Bencsik – Chief Financial and Strategic Officer

Okay. So yes, the NII impact, if you look at the market rate expectations for the Hungarian rate environment, the total cost of reserves for the year is roughly HUF 50 billion. So that's the difference between the Central Bank paying the market rate on reserves as opposed to paying the rate what they asked to pay. Part of the difference we already suffered during the fourth quarter, and we will suffer during the first quarter. But there will be a step up in the second quarter when the reserve requirement doubles. For 25% of the reserve requirement, they don't pay anything. So overall, the rate what they pay on the reserves drops from 13% to 9.75% on average. The difference between this scenario, what we expect and from a very good scenario in which the Central Bank paid the market rate for the reserves is HUF 50 billion. This is already included in our NII and NIM expectations. This is not an extra negative. This be included in our expectations, and this leads to your second question if you go back to maybe the page where we had our guidance.

Second page, the next one. Yes, this is. So again, let's say that the net interest margin may remain stable in 2023. With all these factors considered together, we expect the group level net interest margin to be similar to last year, right? I hope it answers your question. So yes, in euro rates, that's positive. This will have a positive impact in Hungary because we have euro variable assets in Hungary. Obviously, in countries like Slovenia, very big positive Bulgaria, Croatia, even Montenegro. But again, the rest of the group members also have some positive NIM dynamics. It's only Hungary where we had these very substantial and fast change and fast increasing extraordinary negative measures, which push our NIM levels lower. But again, compared to the very low fourth quarter level, we expect improvement during this year, including the new Central Bank reserve policies and assuming the market expectations regarding the rate environment change during this year.

In terms of our liquidity in Hungary, the loan-to-deposit ratio is 55%. We do have fixed rate sovereign portfolio. But when we calculate the LCR ratios, during the presentation I told you that we have close to EUR 8 billion surplus over the LCR requirement, and we have altogether close to EUR19 billion high-quality liquid assets portfolio. So, these numbers include and assume the market value of the sovereign bonds what we have in Hungary and elsewhere. This is the market value. This is the collateral value when we do a repo with these bonds. There's no additional haircut or market value adjustment when we talk about this liquid asset portfolio. These portfolios already include the decline in the repoable value of these assets due to the change in the rate environment.

Gábor Kemény – Autonomous Research

Okay. That's all useful. Just to recap on the full year NII outlook. What you said on the NIM, I would assume it's largely applicable to NII as well because you are not assuming meaningful volume growth this year. So shall we expect the Hungarian NII to be down a bit, which is then counterbalanced by growing NII elsewhere in the euro-linked countries. Is this a fair statement? Or are there any other moving parts?

László Bencsik – Chief Financial and Strategic Officer

Average volumes are growing. So last year, overall, we had 12% loan growth. This year, we expect less than 5%. Last year's growth already implies an average y-o-y growth in volumes. Volumes are growing, but the growth rate is slowing down. I would put it this way: NII growth will slow down. Sales average volumes expected to grow plus the NIM is expected to be more or less similar to last year. I think it's logical to expect some growth. And very important, the group is growing through acquisitions. NKBM is a big bank and a very profitable one. There will be a quite sizable and material additional contribution from this new acquisition, which we closed in February.

This is in the form of a one-off. But more importantly, the contribution of NKBM will be visibly strong during this year.

Operator

The next question is from Mate Nemes, UBS.

Máté Nemes - UBS

Yes. Thank you for the presentation and all the details on net interest margin. I had 3 questions, please. The first one is on volume growth. You mentioned that you would expect around up to 5% growth in 2023. I was wondering if you could give us a sense of the major operating countries in the portfolio, presumably in Hungary, somewhat more muted growth and perhaps somewhat better in countries like Bulgaria, Serbia and so on?

The second question would be on the fixed asset repricing cadence or repricing schedule, specifically in the government securities portfolio, how much of the portfolio is maturing next year, 2024? Then these amounts can be rolled into short-term assets. This should surely help, I suppose, with NII. And the last question would be on the Ipoteka Bank acquisition, specifically the funding plan, if I just look at the gross loan book versus deposits, I see more than HUF 700 billion of higher loans. Could you talk about how you intend to fund the gap? Is that supposed to come from intragroup funding, or you have other solutions?

László Bencsik – Chief Financial and Strategic Officer

For the first question, you just gave the perfect answer. So, probably somewhat muted growth more muted in Hungary and maybe somewhat higher or better growth in countries like Bulgaria, Slovenia, Croatia, Serbia. You gave the perfect answer to your question. Maturity profile, I mean, the total Hungarian sovereign book is HUF3,200 billion. Average adjusted duration is 3 years. This year, there's HUF 400 billion maturing and next year HUF 300 billion. Yes, this is certainly helping the NII as time goes by, but this has already been counted in when I talked about our expectations regarding the Hungarian NIM trajectory or the group level NIM trajectory. These improvements are due to maturing portfolios in Hungarian sovereign bonds and the reinvestment rate being so much higher than the current year. So yes, that's positive. But the much bigger maturities will happen in '25, '26.

Ipoteka takes funding, yes. The bank is funded by refinanced state loans. Most of the mortgage book is subsidized and there's a refinancing provided by various state institutions. They will continue. We don't have to replace these funds. There's no expectation to provide additional funding other than funding additional growth if you decide to do so. There's no immediate funding need to replace current funding, put it this way. The state refinancing structures are going to continue to be there. This is obviously part of the deal and the agreement that we have with the government, with the seller that they will continue to be there.

Máté Nemes – UBS

Okay. Can I ask the -- about the remaining maturity of these state subsidized loans? Is that well beyond 12, 18, 24 months?

László Bencsik – Chief Financial and Strategic Officer

I don't have the exact number. But yes, it's certainly well beyond 12 months that I can say. I don't know the exact numbers, but these are longer-term structures, yes.

Operator

The next question is from an attendee joined via phone.

Robert Brzoza – PKO BP

I have 2 quick questions. One is on the take-up of term deposits in Hungary, because currently, it's about 20% of the total, whereas in the past, it used to be in the range of 50%. What are the most recent trends 4Q versus 3Q? Do you see any acceleration in the behaviour of savers? So that's #1 question.

And #2 is on the cost of risk. You mentioned that the 4Q and winter wasn't so bad in economic terms, then why is that in several countries, you have modified your model parameters resulting in a somewhat higher provisioning charge? This seems sort of some inconsistency between those 2 observations.

László Bencsik – Chief Financial and Strategic Officer

Deposits. I mean, in corporate deposits, as I said, we experienced a very fast repricing, and corporate deposit rates on average are close to 14%. They already repriced during the second half of last year in a very fast manner, and that repricing gap, which I mentioned in my presentation, is one of the reasons why the NII dropped so much in the fourth quarter, the discontinuity between the speed of deposit repricing, corporate deposit repricing and corporate lending pricing.

Retail, there's not so much repricing in retail deposits because the alternative investment opportunities are carrying so much higher yield that it is extremely difficult to compete with them in terms of term deposit rates. What happens is that people who have longer-term savings and want to earn higher yields, either look for money market structures or money market funds or sovereign retail bonds, which are quite liquid and provide inflation plus percent yield. No one wants to compete the deposit rates with those rates, right? It's just impossible. It's a unique situation in Hungary. And these high-yield retail investment opportunities into retail bonds have been there for, I think 5-6 years. People are used to being able, if they want to go for a high yield, to invest into retail government securities, right? And that, that continued.

Therefore, retail deposit rates and volumes are not moving so much. People live up their savings, because if they want to invest into a high-yield structure, they don't go for a term, they go for a retail government bond. I think that's the reason why we don't see so much increase in term deposit volumes. It does exist. But overall, this is as we just stated, a small percentage. I think these are the factors behind this situation.

Then your other question was related to cost of risk for the first quarter. Again, we continue to try to be as conservative as possible with provisioning, and we usually make another push each year-end, and we did that this year end as well. I acknowledge your point that there's some optical inconsistency here. But if you look back at our previous track record, we always try to be very conservative, and this was just reflected here. But I think that's a fair point [what you said].

Operator

The next question is from an attendee joined via phone, again.

Jovan Sikimic - Raiffeisen Bank International

Just a technical question. You include now in your guidance, in ROE guidance for this year, Nova KBM and something from Ipoteka Bank, of course, depending on the timing of consolidation. Is it correct?

László Bencsik – Chief Financial and Strategic Officer

Yes.

Jovan Sikimic - Raiffeisen Bank International

Okay. And would you be able also to provide a like-for-like ROE guidance compared to the group structure that we saw by the end of 2022?

László Bencsik – Chief Financial and Strategic Officer

Yes. It's somewhat lower.

Jovan Sikimic - Raiffeisen Bank International

Okay. Based, of course, on the adjusted numbers, right?

László Bencsik – Chief Financial and Strategic Officer

These are adjusted numbers, yes.

Jovan Sikimic - Raiffeisen Bank International

Okay. And my last one: some government representatives yesterday or the day before mentioned the extension of windfall profit tax. Not being specific on which industry might be negatively or positively impacted. Do you have any idea where the journey might go beyond 2023 on that front?

László Bencsik – Chief Financial and Strategic Officer

Yes, we also observed these comments. And we certainly don't have any further information other than this scattered in March from various representatives of the government. When they introduced this tax last year, they promised that this was for 2 years. And then it's one of the EU requirements to eliminate them starting from next year. That's one of the 27 points, which are the prerequisites for the EU funds to be made available for Hungary. I think this is certainly another good news for us, but I don't have any more detail on this. We are not aware of any specifics. We don't exactly understand what it means. So unfortunately, I cannot comment fully on this one.

Operator

The next question is from Alan Webborn from Societe Generale.

Alan Webborn – Societe Generale

I'm thankful for the call today. On mortgages in Hungary, could you just update us a little bit about how you're managing that market in the current environment? With your assumption that inflation is going to come down, and therefore, rates are going to come down as we go through the year. I mean, do you an inflection point at some point? Or is this year simply going to be continually downward in terms of volumes? I would just be interested in your view of that market.

And I guess, the other side of that is clearly, at the moment, the working capital loans in Hungary that have been giving you the volumes as inflation comes down. Do you think that the longer-term investment type loans will come in to offset? Or do you think there's going to be some pressure there as well? In terms of your overall NII guidance, can we apply that to some extent to fees as well? Or do you think there are other elements at play there as well?

László Bencsik – Chief Financial and Strategic Officer

As I already mentioned, and there were some questions related to the Hungarian growth expectations. And it was rightly said that probably Hungary going to be even more muted relative to the other countries of our portfolio. Certainly, that's true for mortgages. I think it's quite clear that at this rate level demand is very thin. And even if rates go much lower, I don't expect a very big pickup in mortgage lending during this year. I think this is going to remain at a relatively low level for all year.

We started not lending or issuing variable mortgages after the rate cap. I mean, if you cannot trust in the contracts that you have with your client, and if the regulation overrides these contracts, then the only thing you can do is to provide loans with fixed rate for the whole maturity. So that's what we do. We only provide now fixed loans until maturity. And that allows still around 10% rate for mortgages. And even if the short-term rate integrates very fast, this fix maturity rate is not. It’s the short-term reference rate that comes down from 18% to 10%. But the long end of the yield curve is not going to decline so much.

The actual yield of this fixed maturity mortgages is not going to decline as much during this year as the base rate will or is expected to decline. Therefore, I think this is going to be for the course of the year in Hungary. Hopefully, next year, if inflation and rates continue to abate, and risk and all inflationary and rate environment turning around maybe next year, I don't know when, then there might be a stronger pickup in mortgage lending. But I don't think it's likely to happen this year.

Corporate lending, yes, it's already slowed down during the 4Q last year to 2%. And the inflation goes down, maybe it will reduce the inventory or the working capital demand, but even if the inflation goes down it doesn't mean that there's deflation, right? It means the rate of inflation slows down, but it's still high, right? I mean we are going down from 25%. But if you go down to 10%, it's still high inflation, right? It's certainly not deflation. I think corporate loan growth will be less than last year, when we grew 33%, so this year will be less. But maybe, it can easily happen that corporate will be higher than 5%, even closer to 10% this year, for instance in Hungary. So corporate is not so much directly defined by the rate environment and some of them benefit from inflation and they can take FX loans, which the retail clients cannot. There are different dynamics there.

Our fees, in general, we think fees tend to grow in nominal GDP growth terms, right? Now when inflation is so high then fees don't grow so much because transactional volumes decline, as consumption declines, retail trade declines there’s advance of more transactional volumes due to inflation and the decline in the number of transactions due to less retail, less consumption. But I think fee dynamics is going to continue to be strong. I mean the general rule is that high inflation is relatively good for a fee increase. I am more optimistic on the fee side here.

Operator

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

László Bencsik – Chief Financial and Strategic Officer

So, thank you again. Thank you for your time and for your attention. I hope this was useful and thank you for the very good questions you asked. I hope we were reasonably able to answer them. And please come to our next meeting when we present the first quarter results.
I think they are going to be quite interesting to see, especially because we will already see the addition of NKBM to the group, which is a big step for us. A lot to be seen there as well. So in early May, I hope to have you back and till then all the best for you and have a very nice weekend, goodbye.

Operator

Thank you for your participation in the fourth quarter and full year 2022 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.