Strategy and Finance Division

Investor Relations & DCM

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Transcript

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

Operator

Dear ladies and gentlemen, welcome to the OTP Group First Quarter 2022 Conference Call. This conference will be recorded. (Operator Instructions)

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

László Bencsik – Chief Financial and Strategic Officer

Thank you. Thank you very much. Good morning or good afternoon, depending on where you are. Thank you for joining us today on OTP's 2022 first quarter investor call. We presented our numbers. As you can see, on Page 2 maybe we can move to the presentation. Yes.

Overall, we booked a quarterly loss. The profit after tax was negative, which is a rather rare event. But I think circumstances are also quite special and rare. We tried to as much as possible pre-emptively react and reflect the deteriorated expectations in Ukraine and Russia due to the war. That's reflected in the stand-alone Ukrainian and Russian results, which were negative. Altogether, in Russia, we booked minus HUF 27 billion, in Ukraine, minus HUF 34 million equivalent.

But on top of that, we have made certain adjustments necessary to reflect the values of these entities and related to instruments which are associated with Russia, namely the Russian bonds we have outside Russia in Hungary and in Bulgaria to a small extent. As you can see on this chart, we booked HUF 122 billion one-off adjustments. Part of it was kind of recurring "usual" adjustments such as the special bank tax.

These 2, the impairment on the Russian bonds in Hungary and Bulgaria, which is clearly a one-off related to the nominal value of HUF 100 billion equivalent of ruble bonds, which, to be frank, we don't quite understand to a full extent the current legal status of these bonds. Certainly, they are not freely tradable and there's not much market for them, and also, it's kind of unclear whether they are already in a technical default or not or whether they will be.

We took a kind of conservative approach, obviously, with the approval of our auditor to assume that these bonds are in default, and therefore the PD is 1. We apply it in LGD, and we also have for the AFS portfolio made a mark-to-market revaluation, which had an impact on capital. On top of this, we also had another effect, which is reflected in the capital. In the net book value these bonds went down from HUF 100 billion to HUF 40 billion equivalent.

Now the other big one-off here is the goodwill write-off related to the Russian bank. We acquired this entity in 2006. I'm sure you many of you remember, at those times it was quite common to buy assets well above book, and we did so. Therefore, there was an initial goodwill. But this time, it was clear that the valuation of the franchise changed in a way that we had to write off this goodwill. It obviously doesn't have an impact on the regulatory capital because goodwill has already been deducted from regulatory capital. But it does have an impact on the P&L, and it has an impact on the accounting equity of the book.

Then there were 2 more usual lines which go up and down depending on what happens in the group. One is the acquisitions, which was an usual quarterly negative. The other one was the evaluation of the OTP MOL. share swaps. This bigger amount is related to the fact that dividend payments changed a lot compared to the previous expectations. For instance, in case of OTP, after '21, the AGM decided to pay only HUF 1 billion out of the last year results. In case of MOL, there is one big dividend payment. So that required a fair value adjustment of this structure.

Now adjusted profit after tax was HUF 88.6 million, which again lower than last quarter or year-on-year. But it's solely due to the fact that we had losses, as I said, in Ukraine and in Russia. I will show in a bit more detail on this. I mean, we decided that we split the group into Russia, Ukraine, and the rest of the group. That's probably a good way to approach these numbers.

Now looking at capital. Our capital adequacy somewhat declined during the first quarter. It went down to 16.2%. Common equity Tier 1, this is still almost 2x the capital requirement, being 8.8%. So very comfortable. On this slide, you can see the quarterly changes, which had an impact on the regulatory capital, also on risk-weighted assets.

Obviously, here, the overall loss, the fair value adjustment of the AFS portfolios. Here, I'm not just talking about the Russian bonds, but also typically Hungarian bonds, which had a negative mark-to-market valuation on the small portfolio which we keep in AFS. Plus, risk-weighted assets increased. This was partially due to volume growth. We had increasing risk weights, especially, in Ukraine, but also in Russia. Due to the downgrades of the ratings of these countries, we had to increase the standard risk weights for these portfolios, which substantially contributed to the credit risk-weighted asset growth, which was part of this HUF 544 billion increase in the credit risk-weighted asset, what you see on the chart.

So going forward. Well, this is a slide which tried to show the magnitude of the exposure to Russia and Ukraine. This is what we started to show when we talk about the year-end numbers in the previous occasion when we presented. The quarterly change is mostly related to the lower right corner 2 boxes, where you can see the consolidated capital effect. This is the total impact of writing off the Ukrainian bank and the Russian bank. This scenario, we don't expect to happen. We consider this very unlikely and very low probability and extreme bad scenario. This includes the write-off of the group funding and the capital.

Then we have the bonds, the Russian bonds, which are outside Russia. The book value of this went down due to the changes that I just explained. We also adjusted, too, a much smaller portfolio in Russia in terms of Russian books. But here, the market is really split, because these Russian bonds are tradable and can be traded with a relatively small discount in Russia, as opposed to the situation outside Russia, where it's questionable whether they are tradable and it's also even more questionable whether any payment to these bonds can go through the global – primary U.S. – payment system. Therefore, technically, Russia cannot service these bonds according to the original structure.

Now if you look at the next page, you can see that overall, despite high provisioning, the Stage 3 ratio did not increase. It decreased. This, obviously, includes Russia and Ukraine. What we can say that at the end of the first quarter, but also, I can tell you that at the end of April, we did not see material worsening in the portfolios, neither in Russia, nor in Ukraine and nowhere else. The acts of provisioning and the additional risk cost we created are all based on worsening forward-looking expectations and expected loss numbers.

We believe we remain conservative or became even more conservative given the extra provisioning we did in the first quarter. If we compare ourselves to various banks which are either present in Russia and Ukraine, like Raiffeisen Bank being very, very present in Russia, Ukraine and also Belarus, and UniCredit being very strong in Russia, so, if you compare the performing coverages to these banking groups and we compare our numbers, including Russia, Ukraine, with the 2.4% coverage, we seem to be higher. If you compare to banks like Erste, which does not have Russian, Ukrainian operations, and we compare our performing Stage 1 and 2 coverages, then there's also a difference. We continue to believe that we remain reasonably conservative in provisioning, and this is something we try to continue to do in the future as well.

But rolling a bit more into the details of the P&L and looking at the adjusted profit after tax, there are some questions to be discussed on this slide. I think one interesting on: Why the effective tax rate was so much higher than the usual level? Now obviously, it's also related to Russia and Ukraine. Despite having losses in Russia and Ukraine, we have not created deferred tax assets. We did not assume a recognizable tax shield on these losses. On top of that, we have written off the deferred tax assets which we still have related to Russia in our books. It doesn't mean that it's impossible in the future or it won't happen that we can materialize at some point these kind of tax shields or deferred tax assets. It's just the prudent way to reflect these numbers. In line with the goodwill write-off related to Russia, we decided to also write-off the deferred tax asset. The corporate tax increase, what you see here, is related basically to these Russian and Ukrainian activities and the very conservative treatment of deferred tax assets for these 2 countries.

I think the other obvious number to look at is the risk cost. We booked as much risk cost in the first quarter, almost exactly as we did the whole last year. Obviously, you will see that most of it was related to Russia and Ukraine, because for the rest of the group, we released provisions.

Then going forward. You can see the kind of per country division of our contributions to the adjusted profit after tax. Hungary was strong. But basically, in Hungary, Croatia, Serbia, Slovenia and in the leasing company in Hungary, we released provisions in the first quarter. What happened exactly was that we went through this exercise that the COVID situation basically ended after the first quarter. By then, there were no restrictive measures present in any of the countries where we operate. We assumed that basically COVID itself is not going to have negative further impact. Therefore, we started to release the extra provisioning, which we kept year-end last year for COVID reasons because COVID was very much present here in this part of the world and there were still certain restrictions on economic activity and the kind of social activities. At that time, it seemed quite reasonable to maintain these levels. But by the end of the first quarter, it lost its relevance.

In a way, we partially released these provisions. But at the same time, parallel to this, we also looked at the worsening GDP growth expectations. Here I'm primarily talking about outside Russia and Ukraine. Because the recent expectations at the end of the first quarter were worse than what we had before the war broke out year-end last year, we had to update our models. Because of the deterioration of GDP expectations, we had to create additional provisions.

What happened was that we released a big part of the COVID-related provisions, previously created back in '20, and then either released them or reallocated them to IFRS 9 provisions related to worsening GDP expectations. The result of this exercise was different country by country. In some countries, it resulted further provisioning, like in Bulgaria. But in some countries, namely Hungary, Croatia, Serbia, Slovenia and in leasing in Hungary, it did result in some provision release. The biggest one happened in Hungary. These differences in the risk positively affected some countries and obviously had very negative impact in Russia and Ukraine.

Talking about this – I think the next slide is potentially the most meaningful to talk about the group at the moment, because I don't think it makes much sense to talk about the group as one entity. I think we have to slice it into 3. One is the group without Russia and Ukraine. This is where we pretty much have normal operations. COVID is over, inflation is high and GDP growth is somewhat slowing down compared to last year. But fundamentally, we have a reasonable business as usual environment. Therefore, the numbers reflect this situation. We were able to provide you with a reasonably detailed guidance on these numbers. I think somewhat reasonably optimistic guidance on this part of the group.

Now Russia is very different. There is a very special situation in Russia. There is no war, but the war has a huge impact on Russia, especially through the sanctions. Our GDP expectation for this year is around 8%. We calibrated the IFRS 9 models accordingly, and that resulted in an additional provisioning need. We created HUF 33 billion equivalent of additional risk cost. That resulted in this HUF 27 million quarterly loss in Russia.

Again, if you look at the portfolio of Russia, we don't really see signs of deterioration. What we see is the lower volumes and lower volume growth, but not so much deterioration. Therefore, we think that this is probably conservative enough. If there's no further substantial change in how the environment develops compared to what we expect, then it might be or, it could be that we won't have any losses for the future quarters in Russia and we expect positive contribution.

Ukraine, bigger risk costs, HUF 49 billion. Obviously, there is a war situation, which is very dramatic. I mean, as I told you last time when we talked about the fourth quarter results, our colleagues have been working heroically to maintain the bank, maintain the services of the bank and serve our clients and protect the value of the franchise. 80% of the branches are open, all the services are on. We even restarted selectively lending. But despite this, we had to provision strongly. Then, we had 2 approaches. One is we did a bottom-up review of the portfolio and looked at each and every exposure where the client is and where the assets are. Depending on the impact of the war, either direct or indirect impact on these exposures, we classified them to different categories and provisioned them accordingly and moved them to Stage 2 accordingly.

On top of that, we applied an IFRS 9 forward-looking provisioning, increasing coverage levels. Here, the GDP trajectory assumption was 30% decline this year and a very rapid rebound next year, resulting in roughly 10% net decline in 2 years in GDP levels.

Now if you look at the group without Russia and Ukraine and the performance indicators, first quarter, adjusted ROE was quite strong, coming from positive risk cost. As I said, without Russia, Ukraine, this exercise of freeing up COVID-related provisions and creating new IFRS 9 forward-looking provisions based on the GDP expectations resulted in a net positive number, it was HUF 9 billion.

Obviously, these are high ROE and strong adjusted profit of HUF 150 billion, which is like more than 50% up quarter-on-quarter, was strongly bolstered by the positive risk cost. But if you look at the operating profit line, this was also strong, 15% quarterly growth, there's a seasonality in cost. I mean the fact that the first quarter cost was lower than last quarter is not necessarily surprising. But the fact that total income grew 3% in this quarter for this part of the group, I think this is okay. Very importantly, performing loan growth for this part of the portfolio was 3%.

If you look at P&L line, Page 9. NII declined. That might be surprising given the increasing rate environment. The decline comes from 2 countries: one is Russia, where maybe it's not so much a surprise, right, given that primarily because of decline in volumes, that's what happened. You will see that we had in Russia 7% quarter-on-quarter decline in the loan portfolio. Based on that, it may not be surprising that we had minus 6% growth in NII.

It might be somewhat more surprising that we have minus 4%, HUF 4 billion in Hungary. In the next slide, we kind of try to provide some more details, some more flavour on this decline. Because not just NII went down, but the group level and OTP Core net interest margin also declined. So, this is the composition. As you can see, the group level decline was primarily due to Hungary, but the secondary force was Russia again, not surprising, and that might continue to happen.

Looking at what happened in Hungary. I think that's an important question to answer. I mean, this very rapid quarter-on-quarter rate increase had an impact, a negative impact on our swaps. So, there was a swap revaluation result, which was negative. It shouldn't recur so much. So that's potentially a one-off. We don't expect similar to happen in the second quarter.

Then there were some other effects. The corporate and SME loans gradually repriced. There was an upside coming from there, an NII increase and positive margin contribution. Whereas, retail loans, which are almost all fixed – I mean, we have 80% of mortgages fixed, but the remaining 20% is also under the rate cap and kind of 90% of the consumer loan portfolio is fixed. The composition effect is negative because the fast-growing part of the baby loan program, which is of lower rate than the rest, and obviously, very profitable, but with lower rate.

Plus, as you will see, we had 2% decline in consumer loans in the first quarter this year in Hungary due to the fact that retail clients received a one-off windfall of revenues. There was a personal income tax rebate. They received back their personal income tax, which they paid last until the average kind of tax payment. Therefore, people early repaid their consumer loans, but even more importantly, there was an automatic reduction in the use over-the-draft volumes. So as people had this one-off, the overdraft facilities they use up disappeared or they were paid back, rather.

Then we had some gain in financial assets, including the higher return on the National Bank deposits. But this was mitigated by the higher cost of corporate deposits, which tend to increase. We have basically increasing corporate deposit rates and then we placed them into these 2 financial assets, and there's some gain there. So that's overall positive.

The other effect was basically that we had much, much more deposit growth than loan growth. Plus, we had large repo deals, which inflated somewhat the balance sheet. This is kind of balance sheet inflation, which is a negative impact on the NIM itself, not so much on the NII, by the way.

All in, we believe that this quarter-on-quarter negative NII development, HUF 4 billion, that was a one-off event primarily due to the swap revaluation results, and we expect increase and improvement in NII in the second quarter. How exactly it's going to translate on the margin depends on the kind of balance sheet growth impact or the kind of retail, especially, deposit growth and repo facility growth.

Volume-wise overall, we have 3% growth. If we take out Russia and Ukraine, without Russia and Ukraine, we also had 3% growth for the rest of the group. Hungary was 0. So again, that's another unique feature of this quarter. But unlike the last 5 years when Hungary was one of the highest-growing countries in terms of performing loan growth, now it was 0. That 0 is primarily due to this minus 2% consumer loan growth, which I explained why it happened. We don't expect this to continue or repeat. Therefore, we expect for the remaining quarters of this year, consumer loans to start to grow again.

Mortgage growth and corporate growth was there, but somewhat lower. I will give some more detail on mortgages because, here, the situation is somewhat more complicated. We had very high level of applications with a relatively low level of disbursements. I'm going to explain what happened.

Now in Ukraine we had plus 5%, which just reflects that in January, February we had fabulous 2 months, and then the war came. Obviously, we are not going to have further volume growth, or we don't expect further volume growth in Ukraine for the remaining part of the year. Russia was already negative in the first quarter, and this is going to continue. So most likely, the Russian portfolio will continue to decline together with the Ukrainian for the remaining part of the year.

Then the rest of the portfolio is pretty strong. These are just quarterly growth rates: Bulgaria, 6%; Montenegro, Albania, 6%; Slovenia 5%; and Serbia, Croatia, 4%, 4%; Romania, 4%. These are very robust growth rates. And honestly, I don't think you can annualize these, and everyone expects some slowdown potentially in the second half of the year, maybe already in second quarter. But so far, we have not seen that. April remained quite strong. Despite this general expectation that there should be some slowdown in terms of loan growth trajectory, so far we have not experienced that. This applies also for April.

Now in terms of deposit growth, it was again very robust, quarter-on-quarter 4% and 7% in Hungary. Given that in Hungary we have below 50% loan-to-deposit ratio and the fact that loans were not growing and deposits grew 7% in one quarter, that describes this inflation of the balance sheet I just referred to, which is actually profitable, especially the retail one, the 5% you see here, because now the kind of short-term instruments or the kind of 1 week National Bank deposit rate is 6.4%. There's a healthy margin on these retail deposits, right?

Corporate deposits also quite strong and very liquid. There's a lot of liquidity in the market. The rest of the group, it's more up and down depending on how they price deposits and how much you need deposits. But I think the important part here: you can see in Russia, Ukraine, it's increased. There's a lot of extra liquidity coming into these 2 banks. Now we are really reducing our deposits pricing in Russia. For first time ever we are lower than Sberbank in terms of deposit rates, and we continue to cut down deposit rates. This is a previously unknown situation for us and some kind of positive aspect in this overall very dire and sad situation what we have in Russia and Ukraine.

Net fee income, it was quarter-on-quarter negative. But if you look at the reasons of this negative development, one is the fund management. Fund management had a bonus payment. They got a performance bonus they always receive at year-end. We don't know how much it's going to be. This is usually very seasonal. This minus 2 billion in the fund management is due to that. Russia was negative due to the low level of disbursements of new loans. But other than that, it was quite strong. You see Hungary, plus 8%; Bulgaria, plus 6%; Croatia, plus 6%. If you take out Russia, Ukraine and you take out fund management in terms of fees and commissions, it was a strong quarter, and we continue to expect strong performance for the rest of the year.

There, in other income, there was some noise. Other income line was quite high. But here were different technical items and a one-off gain. But really, there was this minus 8% negative and the base effect plus 6%, which kind of net out. Really, one-off was this trading or treasury gain on Russian derivative positions, HUF 9 billion. That's a one-off. I mean that was a result of the volatility and the direction of the volatility during this period. I don't think we are going to repeat them. There was this one-off element in the other income line.

Costs, so far, okay. But obviously, this is something to be watched. Quarter-on-quarter, there's a big decline, but that's due to the seasonality and usually seasonally high fourth quarter. I mean, during the year, we expect strong pressure here due to high inflationary environment almost everywhere. But as we've said, we are committed to try to maintain the efficiency ratios at least at the level of last year.

Now maybe very few sentences about Hungary, a bit more granularity on the loan growth potential. Here, I think what's important is the applications for mortgages because mortgage growth was not so strong. Year-on-year, it was still strong, 23% year-on-year growth. But what really was strong is the new applications.

Maybe if we just jump to the next page, you can see that this new structure in Hungary, the Green Home program, which is – a subsidized structure for new developments and subject to very strict environmental requirements to be fulfilled. There was quite huge application level in the first quarter. These loans were not yet disbursed. Disbursement amounts where, you can see, like 10% of the applied and contracted volumes. That means that this creates a back book, which will appear in the disbursed amounts throughout the course of the year and maybe longer. So that's just to suggest to you that there's reserve here at least in the mortgage growth numbers.

But cash loan flow was weak, the cash loan growth and consumer loan growth, due to this kind of one-off windfall revenue to households. The baby loan disbursement continued. So, it continues till the end of this year. But still strong and we have high market share. Despite some changes in the structure, it's still very profitable.

Corporate was rather not very active in this way. I think corporates, again, are in a waiting mode to see in terms of new investments where the trajectory of the situation is going to lead. So, I think maybe on the corporate level, there might be a somewhat bigger slowdown, at least in Hungary, than we originally expected. But all in, it still grew 1% in the first quarter.

Then ESG remains a very important priority for us. We continue to work on these goals and strategies. The final page is related to the guidance. We carefully worded some changes here and there. Without Russia and Ukraine part of the group where we can be more specific and where, hopefully, these sentences have higher probability and higher relevance.

I mean, we applied slight changes to the wording, which have some message or some information value. Again, based on the first quarter 3% growth, where Hungary was unusually muted due to this one-off event, we think that it's possible to have an annual performing loan growth close to 10%. Net interest margin on year-on-year basis should be quite similar. Here, again, there will be some improvement in Hungary, as I already highlighted.

But the real positive sensitivity now is to the euro rates. So should the euro rate environment increase and should that filter through the other proxy Eurozone or quasi Eurozone countries like Bulgaria and Croatia, what we have in the group then, then there's some tangible benefit expected from the euro rate increase. We expect every 10 basis point increase in the euro rate environment to be equivalent of HUF 2.8 billion annual NII for the group. There's some material sensitivity to the rates here.

Cost efficiency, again, we try to be at least as good as last year despite the fact that inflation is strong and there are strong inflationary pressures and credit costs.

In our last indication we expected somewhat higher level, maybe around 40 basis points for risk costs. Now we seem to be more optimistic on this line after the first quarter and what we see in the second quarter coming. In a reasonably okay scenario, we can be around last year level, which was 19-20 basis points.

If all this goes through, then we should be able to achieve similar ROE that we had last year, at least 18% for this non-Russia and Ukrainian part of the group, adjusted ROE, obviously, because I mean, with this very high one-offs what we already booked in the first quarter, obviously, there will be a bigger difference between reported and adjusted numbers.

Having said that, we plan to conclude 2 acquisitions soon in the – second quarter. Obviously, they will have also some impact even on the – P&L depending on – how the purchase price allocation actually happens and comes out.

In Russia, to our best estimate and understanding, we don't expect further losses for this year. Ukraine is extremely difficult to predict, and swift positive turnaround of events can substantially improve expectations. On the other hand, there are worse scenarios than what we imagine, and they are almost as possible. But even if we proceed on this trajectory what we depicted here, just from the technical features of IFRS 9, meaning that if volumes move from Stage 1 to Stage 2, then we have to switch from 1 year expected loss to lifelong expected loss. There will be additional provisioning needs. How much? It's quite hard to tell.

Then for both entities, we have a strong assumption for going concern and we talked about this deconsolidation scenario last time. But I think the probability of these scenarios is less at least coming from an economic rationale. We really don't see this to happen in Russia from an economic rational perspective, and we are quite hopeful that this is not going to happen in Ukraine as well, and we believe that it won't. These scenarios we consider very low probability and very unlikely. But to be frank, they might do so.

So then, disclosure. As usual, please take those into consideration. I think we can open the floor for questions and answers. So please, if you have any, ask your questions.

QUESTIONS AND ANSWERS

Operator

The first question is from Máté Nemes, UBS Investment Bank.

Máté Nemes – UBS Investment Bank

I have 3 questions, please. The first one is on the NII drop in Hungary. Thank you for the additional details on Slide 10, I believe. You mentioned the 29 basis point NIM decline that was caused by the lower swap result. Could you confirm whether this impact is here to stay or at least could partially reverse in the coming quarters?

Then the second question is on Ukraine and NII in Ukraine specifically. Could you give us a sense of what percentage of clients are servicing their loan instalments? And what portion of NII recognized in Ukraine? Is it actually cash and was it accrual? One of your peers reporting this week mentioned surprisingly high number of clients paying were willing to pay their instalments given the horrible situation in the country. I'm just wondering if you could give us a sense of how this looks like in your portfolio.

And the last question is on the Russian government bond exposures, the HUF 102 billion or HUF 40 billion on net basis from Slide 4. Could you tell us the RDBAs on those Russian bonds?

László Bencsik – Chief Financial and Strategic Officer

Okay. So NII drop in Hungary, the swap – as I said, we don't expect this to repeat. It was like HUF 12 billion quarter-on-quarter minus difference. It was HUF 12 billion the difference on the swap results from one quarter to another. We don't expect this negative to reappear. It was more or less a one-off, although there's going to be as much movement in the rates as we've seen during the last 6 months, which I think that's quite unlikely.

I mean, in Ukraine, basically, we have an overall moratorium. No one is obliged to pay. Despite this 60%, 62% of clients do pay voluntarily. It's higher in corporate and in car loans and somewhat lower in consumer loans. Car loans almost 80% is paying voluntarily.

Risk-weighted assets of the Russian bonds. The bonds which are in Hungary and Bulgaria, they are in – technical default according to our categories. I think it's kind of 100% for the remaining. It's PD-1 and then we have an LGD. And the risk weight here is 100%. We have a much smaller portfolio in Russia, and there, the risk weight increased, to 250" due to the rating. It's very confusing. We don't fully understand the real status of these bonds.

Certainly, the same bonds in Russia, in our Russian banks are traded with some discount, and there doesn't seem to be any – much issue around them. But those which are not in Russia, the bonds – it's pretty unclear what is their actual status and what type of payment can be received or cannot be received on these bonds. We could not find out even for the bonds – which we don't have, but those infamous bonds which had to pay coupons a month ago. Then apparently, as far as we understand, the Russians initiated the payments, but it's not clear for us whether it has gone through the global financial intermediaries, primarily the American banks. So here, we are somewhat in the dock, right?

We decided, again, with a strong view from our auditors to consider them in the fold. But to be honest, we are quite happy if we receive rubles for these bonds and then we exchange them to dollars. That's how the situation seems to be resolved in Russia. We had corporate bonds, dollar bonds, which were paid in ruble. We could convert the rubles the same day without loss. There was no loss on these bonds.

Honestly, I don't know what's going to happen, but I think we have been sufficiently conservative here. My personal opinion is that we are not going to have these losses on these bonds. It's unlikely to materialize these losses on these bonds. They mature in 2025, '26, '27. They have longer maturity.

Operator

The next question is from Gábor Kemény, Autonomous Research.

Gábor Kemény – Autonomous Research LLP

My first question is about Russia, please. Can you talk a bit more about your assumption that Russia is not going to be loss-making going forward? I mean, I recall in the previous 2014, '15 crisis the loss is spread out for a lot longer, I think, maybe for 2 years. And it sounds like this time you expect a much deeper recession than what was in 2014-15.

A related question. Now that you are showing very limited walkaway costs from Russia, how do you think about the pros and cons of withdrawing from Russia?

Yes, my other question is on the provision guidance, which you now guide for 20 basis points for the group ex Russia, Ukraine. I think it's down from around 40 basis points, which you estimated around the AGM. What has really changed? And if you could comment on how much of the overlay provisions, macro-overlay provisions do you have currently?

László Bencsik – Chief Financial and Strategic Officer

Well, there are 2 differences, 2 big differences to 2014 and '15. One is the quality of the portfolio and the nature of the portfolio. I strongly believe that we have a much stronger portfolio today than we used to have. It turned out in '14, '15 that – primarily the credit card portfolio was the – serious issue with that portfolio, right? We learned from these mistakes that were made there in '12, '13, '11, and – very substantially improved our risk management in Russia. This is just a much more resilient and better managed portfolio. That's one difference.

The other difference is that – what we booked in the first quarter in terms of actual risk cost and loss, we booked HUF 27 billion, right? I mean this is the total loss that we expected for this year, right? I mean, in 2014, '15, we didn't have IFRS 9. It took longer for the risk cost to manifest, right? If you think back to '14 first quarter, we didn't create upfront provisions, right? It took much longer for the losses to manifest.

If we look at the actual portfolio quality and the delinquencies and everything, there's not much there to see. It's not at all visible that this portfolio is going to materially deteriorate from what we have seen so far, right? This is – everything we provision –, on top of the usual in Russia is this kind of forward-looking IFRS 9, which if we were back to the accounting regime in '14, where there was no IFRS 9, then this HUF 27 billion loss would manifest probably during 4, 5, 6 quarters.

This is the change in the IFRS methodology. This kind of front-loaded nest of risk costs. So, I think these are the 2 big differences, right?

Gábor Kemény – Autonomous Research LLP

Now, I hear you. Maybe just one follow-up on this. I think in 2014, '15, we were looking at more like HUF 200 billion of provisions over that 2-year period. So that was just materially higher than what you had in 1Q. That's what made me think about the outlook.

László Bencsik – Chief Financial and Strategic Officer

I'm sure. I can see. I mean, Russia – in '14, we had – HUF 14.5 billion loss. In '15, we had HUF 20 billion loss. So that's like HUF 35 billion losses in 2 years. Here – in one quarter we had HUF 27 billion. There's a normal level of risk cost, which comes anyway, right? It doesn't mean that we created all the risk cost for the next 2 years. But maybe we have recognized the – the one-off loss for this year, at least, right? Given that in '14, we had – HUF 15 billion loss or less, it actually makes sense, right, I think.

Your second question: the strategic conclusion. We are open, right? We are open to any discussion, and we have some discussions. But unless we are obliged to do so, we don't want to fire – sell something and destroy value. I mean it would not help anyone. It wouldn't help our investors. It wouldn't help Ukraine if we gave a big gift to Russian investors leaving an asset there for nothing.

On our own, we wouldn't do it, right? But we keep our eyes open, and we consider different scenarios. At the moment, from an economic perspective, we don't see the rationale to do anything, I mean we don't consider this as a situation where we have to do something immediately, disregarding the cost and the potential value, destruction to shareholders.

Having said that, we obviously comply with every regulation and sanction and very careful. And the lending we do in Russia is directed to low-income retail clients, point of sales loans. We will see. We are less concerned about that, right? We're much more concerned about the people in Ukraine and how the situation there gets resolved as soon as possible, because I think that's much more concerning.

What changed since the AGM? Yes. I mean we did this exercise, right? We run the models. We've run them in a very detailed manner. We upgraded all the GDP expectations and everything. That exercise provided us the confidence to say that the first quarter number, this positive HUF 15 billion release, this gives us the confidence to tell you that maybe it's going to be only 20 basis points.

The difference is that we have done a very, very detailed exercise. We made the booking of these provisions exactly based on these calculations. I mean we do have in Russia and Ukraine, I think it's meaningful to talk about overlays. In terms of the rest of the group, we don't have overlays as such. All the provisions are allocated to each and every exposure. We don't have kind of overlay numbers floating around not being allocated anywhere. This has been a very detailed modelling exercise and allocation of provisions, and the provisions are allocated to each and every exposure. We don't so much have overlay. In general, wherever we can be, we try to be more conservative.

Obviously, under the IFRS 9 approach, you have to have a view about the future, which is, by definition, is not correct. Based on that view, you have to build models and you have to build in certain parameter scenarios into the models. There's always a lot of room for judgment, right: more conservative, less conservative, and so on and so on.

We try to continue to be more conservative than less conservative. In general, that approach, results, as an outcome, a seemingly higher level of provisioning than other banks do in the region, right? From this we inferred that probably we are more conservative. But it's not that we have a half a month which kind of floats there as an overlay. In Russia, Ukraine, it's different. Obviously, in Russia, Ukraine, the entire access provision compared to business as usual in Russia and Ukraine, again, is related to expectations which have not manifested. Then I don't know how you call them, overlay or just IFRS 9 provisioning. I don't know.

Operator

The next question is from an attendee joined via phone. (Operator Instructions)

Andrzej Nowaczek – HSBC, Research Division

This is Andrzej Nowaczek, HSBC. I have 3 questions, please. I'm sorry, I have to ask a follow-up question on the Ukraine NII. Can you please explain the accounting for loans under moratorium? You classify them as Stage 2, and I think there was a grace period till end April. But then the NII accrued in 1Q (inaudible) some spike in March. What could the NII be more or less in 2Q?

László Bencsik – Chief Financial and Strategic Officer

Okay. In March and April, there was a general moratorium, but only 38% by volume clients used that moratorium. So more than 60% actually paid voluntarily. Starting from May it's not an overall moratorium. It's case by case. In the retail, we do it based on the income of the clients. It's more automatic. In corporates, it's case by case.

This is going to be the second quarter. I think about this in detail when we talk about the second quarter numbers.

Starting from end of February up until the end of May, we had an overall moratorium and roughly 40% of the net interest income has been accrued, but not collected. 60% flew in as cash. So that was the number for these 2 months. The classification to Stage 2 was one-on-one equivalent to whether they pay or don't pay in the moratorium. It was more like where the client is, where the business of the client is, where the collateral is in the country and what else we know of the client. Based on that basis, corporate case by case and retail basically by location.

This is going to evolve, I think, the approach and the methodology after the second quarter. We will provide more clarity. But again, for the part of the first quarter, which we reported here, is basically March, right, 1 month because those who actually paid end of February, we provided them a moratorium. Kind of half of March NII. Then, roughly 40% of this was just accrued and not collected.

Andrzej Nowaczek – HSBC, Research Division

Yes. My other question is a general question. What are your thoughts on the likelihood of a recession in Europe? How do you think this affects GDP?

László Bencsik – Chief Financial and Strategic Officer

A general recession in Europe?

Andrzej Nowaczek – HSBC, Research Division

Yes. Well, anything bad other than Russia and Ukraine?

László Bencsik – Chief Financial and Strategic Officer

I think it's bad enough. I mean, our GDP expectations for the countries where we operate are not bad, I mean, Hungary, surprisingly, we expect 4.5%, for instance, for this year. We revised it upwards based on the numbers what we see for the first couple of months of the year. So basically, first quarter, first 4 months, we already almost have this growth, right? There was so much growth in the second half of last year and the first quarter this year that even if there's little growth in the remaining part of the year, the overall growth rate would be quite decent.

Bulgaria, we expect 2.5%; Slovenia, almost 5%; Romania, close to 2%; Croatia, higher than 3%; Serbia, higher than 3%, Montenegro, close to 4%; Albania, 3.5%; Russia, Ukraine negative, and Moldova negative. I mean Moldova is in a difficult situation.

Now the situation can deteriorate. But the negative scenarios we see are related to the sanctions as a reaction to the war. It depends how far and fast the sanctions go. I mean, obviously, high inflation due to energy prices, due to food prices. And I think this is difficult enough.

I hope we can collectively cope with this situation in a good way on the European level. Personally, I rather see upside. I know that the recent mood is that it's going to be a very long kind of protected war situation in Russia. But I think we still hope to conclude this relatively swiftly, and then a very robust rebuilding activity can start in Ukraine.

These external threats usually create a sense of purpose and unity. I think this is something Europe badly needed, purpose and unity. Personally, I hope that this is going to strengthen and give a new kind of storyline for Europe. I think that, that can be quite positive.

Andrzej Nowaczek – HSBC, Research Division

Yes. On that note, so you think those new funds will be unfrozen?

László Bencsik – Chief Financial and Strategic Officer

Sorry?

Andrzej Nowaczek – HSBC, Research Division

The implication of what you just said, we'd hope that the new funding will be flowing back to…

László Bencsik – Chief Financial and Strategic Officer

For Hungary, yes. I mean, if you talk about specifically about Hungary, there are 2 issues which need to be addressed and resolved. Obviously, the EU funds and the availability of EU funds, which is a must. The scenario without EU funds would be very dire. Therefore, I don't think this is really a likely one. From reading the communication of the government and people from the government related to this topic, they have been saying that they don't see an obstacle to agree. So there seems to be a commitment on the Hungarian side to reach an agreement. Certainly, it is an economic necessity, I believe.

The other one is the budget deficit. We had an election budget for the last 6 months or 9 months and there was some serious overspending, and that has to be amended promptly. But it's not undoable. If they start early, seems manageable, right? These 2 issues are needed to be fixed. That's very clear.

Andrzej Nowaczek – HSBC, Research Division

Then lastly, very quickly, can you confirm HUF 29 billion of Sberbank resolution charges will be booked in 2Q?

László Bencsik – Chief Financial and Strategic Officer

28, yes. Now that's the gross amount what we have to pay out. I strongly hope that the net amount will be much less. And it depends on how much they can sell the assets of Sberbank for. These are pretty good assets. The actual net amount we book –can be between 0 and –minus HUF 28 billion. And my guess is that it's going to be much closer to 0 than to minus 28 billion.

Operator
The next question is from Ophelia Ramberger, Erste Group.

Ophelia Ramberger – Erste Group

If I understood correctly, you mentioned at some point that you are going to conclude in the second half of this year 2 M&A transactions. One would be the Slovenian Nova. What will be other one?

László Bencsik – Chief Financial and Strategic Officer

It's the Alpha Bank in Albania. Maybe I was not clear. I wanted to say second quarter, not the second half.

Ophelia Ramberger – Erste Group

Second quarter?

László Bencsik – Chief Financial and Strategic Officer

Yes.

Ophelia Ramberger – Erste Group

Okay. And do you see further appetite for potential M&A transactions if there are good opportunities on the market?

László Bencsik – Chief Financial and Strategic Officer

Yes, appetite we have. Good opportunities, we don't.

Operator

The next question is from Alan Webborn, Societe Generale.

Alan Ramsey Webborn – Societe Generale

On that basis, is the – is sort of Uzbekistan sort of not going to happen now? Or is it still waiting for – to see the dust clearing and things to calm down? That was the one question.

Then just as a little point of detail, actually. In Romania and Montenegro, you refer to operational risk events in 2Q, increasing provisions in both countries. I just wondered what an operational risk event was.

László Bencsik – Chief Financial and Strategic Officer

Now Uzbekistan is on hold from our perspective. We talked to the seller that we remain interested, but in this situation, we are not in a position to make a commitment as such until we see how the war situation and the ramifications in Russia and Ukraine play out.

Now obviously, the seller doesn't have any legal obligation to wait for us. If they decide to sell, then they sell. But if they do wait and if the situation improves drastically in Ukraine, and primarily in Ukraine, then we would like to go back to this. We still see the potential. –I mean, it's complex. Given the recent events, it's even more complex. But the fundamental rationale, I think, it's still there. Again, it's on hold and —there's not more to say really on this.

Alan Ramsey Webborn – Societe Generale

What I'm asking is, therefore – is therefore everything on hold other than the 2 acquisitions that you're expecting to complete? This isn't a specific Uzbekistan issue or...

László Bencsik – Chief Financial and Strategic Officer

No, no. We have...

Alan Ramsey Webborn – Societe Generale

Because we're talking about...

László Bencsik – Chief Financial and Strategic Officer

Yes, I understand. Okay. So no, not everything is on hold. We have 3 small discussions or processes now where we are involved. But Uzbekistan is not so much the kind of initial price, but the equity commitment there and that's kind of sizable. It's a much bigger step and really a step outside our comfort zone. It doesn't mean that we stop doing everything else.

At the moment, we are actually working on 3 issues, but compared to Uzbekistan, they are small opportunities. As I just said, we have not lost our appetite. Whenever something comes interesting, we will look into.

Now Montenegro, Romania, these are very different, and both are very unfortunate. In Montenegro, our internal controls revealed a kind of, I have to say, illicit activity in the bank, which caused a loss for the bank and loss for clients. We reimbursed the clients totally and took appropriate measures and reported it to authorities and started procedures. So that's basically thrown. It's localized and we believe that we fully uncovered this situation, and the impact is fully reflected in the first quarter numbers.

Romania, it's a very different – that's another fraud. But it's a corporate case, where we did everything according to the book. There's a dispute whether the person who acted representing a certain corporate client had the right to represent the corporate client despite the fact that all the documents which were presented to us, in our understanding, we're valid. It's a legal case. In this case, we believe we have not done anything which we could have done better. It's really one transaction, the corporate transaction.

In the Montenegrin case, it was an internal fraud, unfortunately, which we ourselves investigated, identified, and took very immediate and very strong measures. But unfortunately, we could not stop the losses and we had to reimburse the clients.

Alan Ramsey Webborn – Societe Generale

I guess the question is in terms of your own internal control. Inevitably, as a group, you've expanded significantly over a long period. I think you've shown us that in terms of whether it's integrating new businesses, you're good at that. I guess seeing 2 issues with fraud attached, however they're done, in a single quarter, does it make you reflect on the regulatory the internal control processes that you have across the group to make sure these things don't happen, reputational and everything else.

László Bencsik – Chief Financial and Strategic Officer

Well, of course, they do, yes. I mean, whenever we have an operational risk event, we institutionally draw conclusions. So, we strengthened our kind of level of defences on a local level, and we try to draw as much conclusion for improving group general practices as well.

I think it's just pure coincidence that these 2 happened in the same quarter. The 2 cases are as different as 2 events like this can be. It happened in completely disconnected markets in a way. It's just pure coincidence that they happened in the same quarter. Thanks God, these types of events happen quite rarely. It's not that every quarter we have this kind of event.

Operator

(Operator Instructions) There's a question from Máté Nemes.

Máté Nemes – UBS Investment Bank, Research Division

I just had a follow-up question on Ukraine still. You mentioned that your macro assumptions assume about a 30% drop in GDP this year and a similar rebound next year and the general provisions or IFRS 9 provisions are obviously predicate on this scenario. I appreciate it's incredibly difficult to give sensitivities here. But how would the provisioning needs broadly change if that rebound next year was significantly lower, let's say, 10%? Could you give us some sense on that?

László Bencsik – Chief Financial and Strategic Officer

I mean, directionally, we would need more provisions. Losses would be higher. We can run the models, right? I mean, numerically, we can calculate anything. This scenario, I don't have it in front of me. We have this for the whole group, we have a centralized database, where everything is there on an individual exposure level basis, and we can run these models in an hour maybe or even less.

This is – we can calculate these numbers, and it's possible. I don't have it in front me. I mean, the range of potential losses is actually very broad. It's not just the actual GDP impact. Well, take a scenario which is quite bad, but at the moment seems possible: that Russia occupies, I don't know, Eastern and Southern Ukraine permanently. So how do you account for that fact, right, in terms of Ukraine and GDP? So even the definition here is difficult, right? Because that part of the country is then lost to Russia. We would not be able to do any activity there. We wouldn't want to as well probably, right? But we were not allowed.

There's this technical event, right? If territorial control is lost permanently over a part of Ukraine, then, technically, I guess that GDP content is lost. Immediate sanctions would kick in, so we would have to write-off those portfolios. That would be a one-off loss, right?

I don't know how you can reconcile that with this IFRS 9 models. That's the other thing. I mean we run this IFRS 9 models because that's what we need to do. But you should not forget that these IFRS 9 models were developed based on normal cyclical changes in GDP. And I think the COVID situation was very clear, and I think it proved very clearly and obviously that the IFRS 9 models simply don't work in situations which are not cyclical economic cycles, right?

But kind of one-off external events like in 2020, we had a virus, which the implication was very large GDP contraction in 2020, right? And a very large rebound last year. And I think it was not just our experience that the IFRS 9 provisioning what we made in 2020 was not needed. These and forecasted losses by the model based on GDP changes despite GDP changing according to expectations, the losses didn't manifest, right? It's just because these models have not been developed for these scenarios. They fit to these long-term economic cycles: advance when GDP goes up, and there's a recession and when there's a war, that's completely different.

Maybe I shouldn't say that, but I have strong doubts how well the IFRS 9 models can capture these types of situations. That doubt I have is based on the experience what we and other banks had during the COVID situation. So therefore, what we do in Ukraine and where I have much more confidence in is really a bottom-up approach, where we look at each and every corporate client and classify them given where they operate, what they do. We try to develop kind of geography and war and kind of level of impact by the war rating metrics, where we classify retail portfolios as well and try to create a bottom-up stage classification, which quarter-by-quarter reflects the actual situation. I think this is more reliable. But obviously, it's hard to do in a forward-looking basis, right? We don't know what the bottom-up approach will result in 1 or 2 or 3 quarters.

We can calculate what you asked for and we can send you the number. But honestly I wouldn't draw too much conclusion from that. It can be somewhat misleading, I would even say, right?

Máté Nemes – UBS Investment Bank, Research Division

I agree with you. I think some of these models are certainly not fit for accurately reflecting, let's say, forward-looking risks in a disruptive or not ex book type of normal cyclical scenario. So I hear you.

Operator

(Operator Instructions) As there are no further questions, I hand back to the speaker.

László Bencsik – Chief Financial and Strategic Officer

Thank you very much. Thank you for participating. Thank you for your interest. Thank you for your very good questions. I wish you all the best, good health, nice weekend. And I hope you will join us next time when we report the second quarter numbers. I believe it's on the kind of first week of first Friday of August, somewhere in the beginning of August. So hopefully, can welcome you back then. Till then, all the best, and goodbye.

Operator

Thank you for your participation. The first quarter 2022 conference call is closed now.