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Transcript

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PRESENTATION

Operator

Dear ladies and gentlemen, welcome to the OTP Bank Third Quarter 2020 Conference Call. This conference will be recorded. (Operator Instructions) May I now hand you over to László Bencsik, Chief Financial and Strategic Officer. László, please go ahead.

László Bencsik - Chief Financial and Strategic Officer

Welcome you today on the third quarter 2020 conference for OTP Group results. I'm especially grateful that you joined us today because there's admittedly more exciting event going on, a concomitant event of the U.S. elections deciding moments. But I really appreciate that you're listening to us in this moment instead of that event.

As usual, you have the presentation available on the website, so you can download it and follow it at your own pace. And we're also using the new Zoom technology. We also present you on the screen and as I present, we are going to move forward. So, as usual, I'm going to give a short presentation. Well, not that short, we'll see, and then we can have a Q&A session. I'm sure you'll have many smart and interesting questions to ask.

Starting on Page 2 of the presentation, you can see the third quarter results of HUF 117.7 billion after-tax adjusted profit and HUF 113.6 billion accounting profit in the third quarter, which amounts to a considerable improvement compared to second quarter. And with this amount in the first 9 months we booked HUF 231.7 billion of adjusted profit.

And if you look at the accounting profit, that was HUF 188.2 billion in the first 9 months. The difference between those two are explained at the bottom of the page in this box. As usual, we had the bank tax in the first quarter, and then we also had an item which we have the first time. It was the expected one-off negative effect of the first phase of the moratorium in Hungary. We booked originally a higher amount, more than HUF 20 billion, but as we understood exactly how many clients participate, this amount became somewhat less but altogether, it's HUF 17.4 billion.

I'd like to remark here that two more additional amounts are expected to come in the fourth quarter related to this. As you probably know there was an extension of the moratorium in Hungary, so there will be a negative NPV adjustment related to it with a much smaller number than the HUF 17.4 billion, primarily for two reasons.

First, it's shorter, it's 6 months as opposed to 9 months, the original one. And also we expect less participation. And the other one is a similar effect coming through our Serbian books because there, the moratorium initially started as one where we could account interest on unpaid interest, but then retrospective with the regulatory change we will have to account for some losses in Serbia, as well. These two numbers will come as one-off items in the fourth quarter.

And then the effect of acquisitions, that's primarily the cost of the ongoing transformation and merger projects. The biggest one we finished in May, in Bulgaria, where we concluded the merger at the beginning of May. But there are two more processes: an ongoing one in Montenegro, which is expected to end by the end of this year, and the other one in Serbia, which is expected to end in the first half next year.

With these remarks, if we go to Page 3, you can see more detailed one-off numbers here, but that's basically the same what I just explained on the previous slides.

I think we can safely continue to Page 4, where you can see the P&L. I think here the most interesting part as the third quarter compared to the second quarter and especially the FX-adjusted numbers here on the right side.

We had a quite strong quarter, I would say. As you can see, total income went up by 5%, whereas interest income increased, too, but more importantly, net fees and commissions went up by 12%. This is mostly because of the fact that during the lockdowns in the second quarter, economic activity dropped and therefore, transaction volumes and values dropped. Therefore, our transactions-related fees and commissions revenues dropped significantly in the second quarter. And then in the third quarter, we witnessed a rebound where in line with the increasing transactions and economic activity related revenues increased, as well. Costs were reasonably contained at 2% FX-adjusted.

Obviously, the biggest difference was on the line of total risk costs, which was HUF 39.1 billion in the second quarter and only HUF 5.1 billion in the third quarter. I will talk more about the risks, but fundamentally, what happened was that in the first and second quarter we created additional provisions in a conservative manner to cover the expected losses coming from the COVID situation. And since the portfolio quality itself remained quite stable, our Stage 3 ratio and our 90 days past due ratio declined in the third quarter. There was no reason to create additional provisions, so we somewhat reshuffled and reassigned the provisions that we created in the first and second quarters in the third quarter.

The next slide is about our capital position. The Common Equity Tier 1 ratio ended up being at 14.6% at the end of the third quarter. Here you can see the elements which had an impact on it. We counted in the interim profits of the first 9 months. That means that we did an audit review. And obviously, we deducted the dividend payment according to our guidance that we were going to suggest a dividend payment, which also compensates for the unpaid dividends after '19, plus an additional amount reflecting this year.

But that's just a tactical calculation based on the Commissions Regulation, which defines how the dividend has to be calculated for the eligible interim profit in case there is no accepted and approved dividend policy in place.

There are two further regulatory changes to be implemented − or one regulatory change to be implemented by the end of the year. That's the preferential treatment of software as intangible goods. The impact is expected to be around 25 basis points. And we plan to finish the divestiture of our Slovakian bank also before the year-end. Here, we are waiting for ECB approval for KBC to execute the transaction. These two items will most likely lift up our Common Equity Tier 1 ratio by 35 basis points by year-end, in themselves.

On Page 6, we reiterated or rather fine-tuned our expectations for this year. You may remember that after the second quarter, we gave certain provisional guidance or expectation numbers, but we have to emphasize here, and we did that after the second quarter as well that the environment is quite uncertain. And it's due to the pandemic situation, it is even more difficult than usual to foresee events.

Nevertheless, we have these three lines of provisional guidance which changed slightly. Originally, at the end of the second quarter, we said that the adjusted ROE might exceed 10%. It seems that we materially exceeded the 10% number. Looking at the first 9 months actual data, which was 13.2%, it's probably not surprising to flag this expectation.

The second one was, which we said at the end of the second quarter, related to the credit risk cost rate. We said that it was probably going to be around 125 basis points. Given again that the first 9 months number was 114 basis points, there's a slight modification here. We say that it may not exceed 125 basis points.

Finally, the volume growth, as you will see in the presentation, in the first 9 months, we had 6% performing FX-adjusted volume growth and the original guidance we made was around 7%. Now we are saying that it will probably increase by more than 7%. The growth will exceed the 7% level. We reiterate the capital targets and we reiterate our intention to pay dividends, as we said again after the second quarter.

If we move forward to the composition of the total group profit at the different entities, we can see that while all in all, in every case except the Hungarian leasing company, the year-on-year performance was negative, so profits declined compared to last year, and this is primarily explained by higher provisions, especially in the first half of the year.

If we look at what happened in the third quarter, again, mostly the driver was the risk cost volume. In two cases we created further provisions: in the case of Bulgaria and Croatia, they increased provisioning. And in the case of Hungary, there was a positive risk cost due to the fact that we are still experiencing strong positive recoveries from our old NPL volumes at the Factoring, the work-out unit in Hungary that contributed more than HUF 10 billion positive in the third quarter, and that turned the risk cost into a HUF 9 billion positive number in Hungary.

And we have two countries, Russia and Ukraine, where we also released some provisions. Basically in these two countries, the portfolios are relatively short term and there are no meaningful moratoriums, so the underlying portfolio quality indicators measure very well the portfolio quality. Therefore, this kind of forward-looking provisions which we created in the first quarter, some of them, we seem to be kind of over-provisioned, and so we reduced provisions accordingly.

Page 8 talks about total revenues. Quarter-on-quarter we had altogether a 4% increase. And across the board, we see increasing numbers quarter-on-quarter with the exception of Romania, Russia and Slovakia. So, it's not just Hungary, but it's basically across the board where we have seen better revenue numbers on a quarterly basis.

If we dig deeper into net interest income, then we see a 1% growth on a quarterly level. Here, it's more mix, I would say. We put some comments on this slide behind the most important changes.

In Hungary we have higher margin: after many, many years, net interest margin, at least on a quarterly basis, started increasing as opposed to decrease what we used to have. And also there was volume growth, so those two together translated into higher NII.

In Bulgaria, we had improvement. In the second quarter it was lower than usual because of the regulatory requirement according to that for a period of time, we were not allowed to charge penalty interest. That was a drag on the second quarter revenue, and therefore on a quarter-on-quarter basis, we made improvement.

In case of Serbia, we see very positive trends there. It's not just a very dynamic volume growth, but also improving margins. So, this is a great environment for us at the moment. And we continue to witness lower revenues in Russia due to somewhat lower margins, but also continuously declining volumes.

On the next page, we see the contributors to the change in the net interest margin on a quarterly basis. Unfortunately, the group level margin compression continued, albeit by a much lower rate than it used to. So there's a very prominent deceleration, slowing down of margin compression on the group level. If you look at this chart, you can see that, in fact, it was induced almost entirely by the exchange rate effect. That comes from the angle that both the rouble and the hryvnia depreciated during the third quarter compared to the Hungarian forint. And our Russian and Ukrainian operations are the highest-margin operations, so when the exchange rates weakens or depreciates, then the contribution to the total becomes less. And therefore, it moves the overall group margin downwards. So, this explained 5 basis points out of the 7.

As you can see in the lower part of the slide, in Hungary, and also in Bulgaria, we saw quarter-on-quarter increase in the net interest margin. This also happened in Serbia, where the improvement in the net interest margin was quite pronounced. That's a good news, at least that's how we interpret it.

Then going to volumes. Performing loans increased by 3% in the third quarter. So, the volume dynamic was something like in the first quarter, where we had 3% growth. The second quarter was minus 0, so very small contraction. Then in the third quarter, we returned to this 3% growth rate, which was pretty much what we saw before or we had seen before the COVID breakout.

Having said that, we have to note here that volume growth is somewhat bolstered by the moratoriums, especially in Hungary and Serbia, where the participation rates during the third quarter were still high. In these two countries, obviously, the volume growth is at least partially explained by the moratoriums.

Having said that, in Hungary, we had 5% growth just in one quarter. Again, it's important that these are not annualized numbers. These are actual growth rates for just one quarter, the third quarter. It's worth noting that in Hungary, we had 10% consumer loan growth altogether. Part of it was explained by the baby shower loan. There will be a slide about that – it continues to be strong. But the market-based cash loan was also growing 6%, which is good. Housing loans grew by 4% and corporate altogether by 4%, too, and within that, SME growth was quite pronounced and more about that later.

Bulgaria started to grow. In the first half of the year, it was quite sluggish so this is quite good news. Croatia stayed stable. Serbia continued to grow with this high pace, but again, there's a relatively high share of moratorium. Slovenia is stable. Romania, 4%, that's very good. In Romania, we are executing an organic growth strategy, so we are investing into organic growth, which is not just seen in the volumes, but also in our cost base, which is growing there faster than the other parts of the group. But that's because we are heavily investing in our capacity to serve more clients and manifests in higher volumes.

Ukraine very nicely turned around in the third quarter. Russia flattened. Russia was quite negative in the second quarter and this is a much better performance. And we see quite strong growth in Moldova and in Albania, our new acquisitions.

All in all, we saw that in the second quarter loan demand dropped significantly due to the lockdowns and the COVID situation. But already in the third quarter, we experienced quite a sharp comeback and rebound in terms of demand for loans and ultimately loan growth.

If we look at Page 12, we can see how the numbers shaped up, if we look at the first 9 months, the year-to-date numbers for this year. Altogether, we have 6% growth. And the story is pretty much what I explained on the previous page: Hungary, +13%; Serbia, +12%, bolstered by moratoriums, especially strong in Hungary was the consumer loan and the housing loan growth. And overall, Russia after 9 months is still quite negative. This is because in Russia, we have the short-term consumer loans as almost 90% of the portfolio. And as soon as demand drops, immediately, we can see the results and the impact in our volumes. So, that's what happened in the second quarter primarily. This is still a strong impact on our year-to-date volume dynamics in Russia.

As you can see, the strong third quarter performance in Ukraine already turned around the Ukrainian performance on the first 9 months basis. And there are some countries like Moldova that do extremely well, also Albania and Romania - as I mentioned, due to this focused organic growth strategy what we have there. And the laggards are basically Bulgaria and Slovenia, where we see more or less flat in terms of volumes after the first 9 months.

Let's turn to the deposit volumes and deposit volume growth ratios in the third quarter. 4% altogether, basically positive across the board, except Russia. Russia is self-funded, so we need deposits to fund our loan book. If the loan book is smaller, then we need less deposits. And since the rate environment is certainly positive in Russia, so we do have to pay for deposits. We only try to keep as much deposits as we need to finance our loan book. So, this was a deliberate action there that we did not renew some of the more expensive deposits in order not to have unnecessary interest expenses.

If you look at the first 9 months numbers in terms of deposit growth, it's 6%. So, same growth rate as we had in performing loan volumes. However, since our group level net loan-to-deposit ratio is only 78%, we have HUF 3.741 trillion more deposits than loans, so the same growth rate resulted in more than HUF 300 billion increase in the deposit - loan gap and increased our liquid assets basically.

As I mentioned, in case of Russia, there's this minus 16% deposit growth. That's due to the fact that we just did not need funding. In Montenegro it's an interesting situation, because they don't have their own currency. They use euro, and because the summer season was quite weak on tourism, and typically, they have the euro inflow during the tourist season, it was much less this year. So, they had some deposit decline in Montenegro.

Now leaving behind the net interest income and these constituents, we go to the net fee income. On this line, we see an 11% growth. Altogether quarter-on-quarter very strong and most of it came from the Hungarian operation.

Part of this growth, as we have here in the text on the right side, is coming from transaction-related card and other payments-related transactional revenues and part of it is related to securities commissions. There's HUF 1.2 billion equivalent, which is a technical item, so it's a plus in case of OTP Core Hungary, and it's a minus for the fund management company. And that's basically just an intergroup accounting event which happened. But beside this, we had other securities related revenues causing the increase in Hungary, especially coming from the retail government bond distributions.

Overall, what we see is that across the countries, as you can see, we had quite high growth rates. Sometimes it's more than 20%. This is just because of the rebound in economic activities. So, as economic activity improved in the third quarter, our transaction-related fee income improved immediately.

Going to other income, there was a 6% growth quarter-on-quarter. This is good because you may remember that in the second quarter, we had a one-off item across basically 5 countries. This is the Visa shares and we had to book the revaluation of these shares in the P&L. And that was quite positive, you can see in the slide the revenue contribution in the second quarter. This was a one-off, so it obviously did not happen in the third quarter. And despite the fact that this HUF 5.7 billion was missing from the third quarter compared to the second, we managed to improve by HUF 1 billion the other income as well, which is primarily related to better trading and FX results.

The next page is about operating costs. It makes more sense to look at year-on-year, so the first 9 months compared to last year first 9 months. Then we have to take into consideration the acquisitions what were made. So, in case of Serbia, Montenegro, Slovenia, these are the new acquisitions and also Albania and Moldova. Therefore, it makes more sense to look at the right side where we have two numbers, which is also in bold at the top line here and adds to be that acquisition numbers. And also, obviously, the FX rates have an impact on these numbers, as well, and they kept changing.

If you look at the FX-adjusted and acquisition-adjusted numbers, then overall, we had 3.4% year-on-year growth. If you go country-by-country, the Hungarian number is 7%. It includes the HUF 3 billion one-off, which was COVID-related expenses. We made some donations and extra cost occurred for protecting our clients and people.

Other than that, we had an increase in the personnel expenses line and also a 7% increase in depreciation, which reflects the very high investments that we have made into our IT infrastructure during the last 3 years. Therefore, this kind of increase in depreciation is going to continue in the future, reflecting the investments that we make into IT.

Bulgaria is flat, and that's because the integration and mergers cost synergies come gradually. That improved the cost situation here. And in Croatia, we have been quite efficient and managed to contain costs. In Serbia, we reduced the cost base by 14% year-on-year, coming from the first acquisition and the cost synergies from the first acquisition. So, there will be another end of cost synergies somewhere second half of next year when we will benefit from the second acquisitions, merger and cost synergies.

Romania, 19% year-on-year growth in operating costs. That's driven by the organic growth strategy what we have. As I alluded to it on the volume growth slides, we have quite a strong volume dynamics in Romania, and that is driven by the strong investments into our capacity to grow and that means higher costs. I think these are the most notable points on this slide.

Then we can now dive into the situation in Hungary, which is still our biggest market and basically continues to contribute roughly 50% the profit. So, Hungarian retail, quite strong volume dynamics year-on-year. As you can see, mortgage loan disbursement for the first 9 months this year was 23% higher than last year. So, that's a phenomenon we can observe in many countries that mortgage loan growth and demand for mortgages have remained quite elevated despite the virus situation.

In mortgages, we reached 33.6% market share of new production and it continues to increase, which is quite remarkable. I think that from these high levels, we managed to further increase our market share. We remain active in distributing the subsidy program, the housing subsidy, the non-refundable subsidies coming from the state.

In cash loans, unsecured lending, the year-on-year growth was 19%. Here, we lost some market share, but it's still quite strong and robust. And finally, on this slide, you can see our market share in terms of household savings. It continues to edge upwards, so 32.3%. That's very good. We didn't make much money on deposits at the moment because of the very low rate environment. But nevertheless, this is a good indicator of our popularity among clients and our overall market share in client context.

If we go to the next page, then we see further details on the baby loan. This is the subsidized cash loan where there is 100% state guarantee behind. As you can see, we continue to sell strong and high amounts. So, we sold HUF 65 billion in the third quarter. Our market share from these products distribution is quite high, higher than usual, it's 42.2%. So it continues to contribute to volume growth and the earnings growth, as well.

If we turn our attention to the corporate side, then I think similarly, positive trends can be observed. Overall, year-to-date, large corporate volumes grew by 3%, but micro and small volumes grew 40%. And this is directly linked to the Funding for Growth Go programme. There's a new version of the Funding for Growth program provided by the National Bank of Hungary to the banking sector. It's a refunded program and it comes with a high proportion, around 80%, 90% of these volumes are guaranteed by Garantiqa. So, most of it is state guaranteed.

This is a very important program at the moment in Hungary. It helps a lot to mitigate the negative impacts of the COVID situation of the negative economic environment which we are in and instrumental in the success of the country. We have quite high market share in the Funding for Growth Go programme. The new program is 25%, which is higher than our market share in overall corporate loans, which is 15.5%.

The next section is about portfolio quality. Before we go into portfolio quality, it's probably worth talking a little bit about our expectations related to the economic environment, which is obviously the fundamental driver behind portfolio quality. This page describes our expectations regarding Hungary, the Hungarian GDP and macro parameters. We expect somewhat higher than 6%, maybe around 6% recession this year and close to 6%, or somewhat lower than 6% growth next year.

With a mild reduction in household consumption and relatively flat investment levels and a short-term jump in unemployment, up from 3.4% to 4.7%, but it should go back to 4% next year. And real wages, we expect to continue to grow this year and into next year.

Now the fundamental assumption behind this scenario and next page, we'll talk about the other countries' expected developments. We have the same underlying assumption, and that assumption is that we expect the second half of next year more or less coming back to normal. And that means and our expectation is that the COVID situation is going to abate by the end of the first half. And that assumes that we have vaccines available somewhere starting next year and in mass volumes by the end of the first half 2021.

These are the macro developments, the numbers what we expect for this year and for next year for all the countries where we operate. Obviously, the recent developments across Europe and specifically in these countries, seem to be a quite serious and the second wave of the pandemic might have some impact on these numbers. The most important driver here is whether we'll have the vaccine or not during the first half of next year. And if we do, then by the second half, we should come back to normalized environments and levels where we can continue to grow.

There's another factor, which is very important here, and that's the moratorium. Obviously, before we talk about the portfolio quality dynamics, it's worth looking at the moratorium situation across the group because this obviously has an impact on the numbers and the underlying risk developments, as well.

First of all, I'd like to reiterate the note what I made on the first page that we expect a one-off related to Hungary and Serbia coming into our earnings, negative one-offs in the fourth quarter related in Hungary to the extension of the moratorium and in Serbia to the fact that the government actually retrospectively changed the nature of the accounting treatment of the accrued interest.

Having said that, you see the participation rates on the right column. I try to give a little bit more flavour on what to expect. So, in Hungary, there's a relatively high participation, it's 42% of the total gross loans in Hungary, household's 53% and corporate 29%. Here, basically, the moratorium has been extended until end of June next year. And there, the difference is that now we have certain eligibility criteria for retail. In retail it remains an opt-out structure, but in corporate it actually changes into opt-in. And for corporates the eligibility criteria are stricter.

The expectation is that there will be somewhat less participation next year. And it will certainly last until the end of the first half. The ultimate underlying portfolio metrics, we'll only be able to measure somewhere in the third quarter next year.

In Bulgaria, the moratorium was introduced at the end of March and it is for 6 months. And although application was possible until the end of September, it was quite front-loaded, so clients typically applied at the beginning. That means that in Bulgaria, we are starting to see, from October clients exiting the moratorium. And by year-end, when we'll talk about the fourth quarter numbers, we will more or less see how these clients behave after the moratorium.

The situation is similar in Croatia, where typically moratoriums were for 6 months. Although it was possible to do it for 12 months for corporate and also it was front-loaded starting from early April, we are seeing in October, November clients exiting from the moratorium. So, by year-end, when we will present the fourth quarter numbers, we will have a reasonably good picture about the behaviour of those clients.

A similar situation applies to Serbia, where the moratorium already expired by the 1st of October. There are some discussions and some rumour about extending it, but so far, it has not happened. So, this is a relatively high participation level moratorium with 44% at the end of September. But today or starting from October, it's basically over, so there's 0 clients remaining in this structure. So again, Serbia is another country where by the end of the fourth quarter, we will see how these clients behave, those clients who exited the moratorium.

Now in Slovenia, the participation rate is much lower than in other countries and is still possible to apply for a moratorium. So, in Slovenia, it will take much longer to see the end game for these clients, but it's a relatively low participation level.

In Romania, the moratorium term was 9 months, and applications were valid until end of September. But no moratorium can last longer than year-end. In fact, in Romania, we will see the volume exiting the moratorium just only at the end of the year or starting next year. So, in Romania, we will see the intrinsic portfolio qualities from the numbers at the end of the first quarter.

In Ukraine, there was no moratorium. In Russia, negligible participation rates. In Montenegro, most of the moratorium is over. There's still some new structures left, but the bulk of it was done. Albania, it's about to end. Applications were allowed until the end of August and maximum for 3 months. Albania is also in the category where we will see the final numbers, how these clients behave in the fourth quarter. Moldova was over during the summer, so in Moldova, for many months, there's no moratorium left.

That means that there's a group of countries for which we are going to know much more about the intrinsic client behaviour of those who exit the moratoriums by the end of this year. You will see those numbers at the end of the fourth quarter or when we publish the fourth quarter numbers next year. And it's basically Bulgaria, Croatia, Serbia and then Montenegro and Albania. And for Hungary, it's third quarter next year. And for Romania, it's end of first quarter this year, Ukraine and Russia, no moratoriums.

That's more or less the overall picture. I'm sure you will have many questions, but this is basically what I can tell you. This is the situation related to the moratoriums. These are the participation rates. And I just tried to explain that based on the extension of these moratoriums in terms of timing, when we can expect actual hard numbers about the clients who exit these moratoriums.

If we move to the next page, then we see the kind of high-level risk-related indicators. The good news is that in the third quarter, both the Stage 3 ratio and the 90-days-plus ratios declined. Obviously, the 90-days past due is part of the Stage 3. Stage 3 is the old NPL, more or less.

Coverage levels remained the same, so we had roughly 65% coverage, that means provisions over Stage 3 loans In case of 90-days plus due loans, we use the old coverage definition, which is basically total provisions over 90-days past due loans. The total provisions divided by the volume of 90-days plus due loans is 140%.

If you look at the actual portfolio deterioration, volumes entering the 90-days bucket were very low. It was HUF 12 billion only, which is lower than a year ago in the third quarter of 2019, roughly half. And keep in mind that since then, the group has increased by the Slovenian bank, so we have a much bigger loan volume base for that. And the risk cost rate in the first 9 months was 1.14% and the third quarter was technically at 0.

On the next slide, there's a lot of information and lots of stories. Maybe it's worth starting at the Stage 2 ratios. On a group level, there was an increase from year-end to the end of the first quarter. You may remember that this is when the COVID situation hit and we immediately identified volumes within the corporate book, we moved from Stage 1 to Stage 2 specific corporate clients based on the industries and the client specifics, which we thought at that time that might be vulnerable to the new situation. That was this reclassification from Stage 1 to Stage 2 in the first quarter related to corporate exposures. That's the explanation behind this increase here.

Then in the first and second quarters related to retail, if you may remember, we explained this at that time. In retail, we did not reclassify. We kept in Stage 1 the unidentified Stage 2. We just increased provisioning. And in the third quarter, in many countries, we made that move. So, we took out volumes from Stage 1 and put them into Stage 2 in retail. And this is the event which explains the increase in Stage 2 ratios in the third quarter.

Now obviously, each country is different. We have different situations here. So, maybe starting with Russia and Ukraine. In these two countries, the loan books are quite short term. Even the corporate loan book in Ukraine is quite short term, number one. Number two, that in these two countries, either we don't have at all moratoriums like in Ukraine or the participation levels are very low, so therefore, they don't really have any impact on portfolio quality. Therefore, in Russia and Ukraine the numbers you see reflect the exact situation of the portfolio quality. So, here, we did not move volumes from second to third quarter anywhere, and what you see here is just where we see in the underlying portfolio quality indicators are.

Well, in Hungary we did, for retail clients, a bottom-up exercise and looked their rating there. If the change in the rating was significant, then we, using the bottom-up approach, reclassified loans from Stage 1 to Stage 2. And there's a group of countries, Bulgaria, Croatia, Serbia, Romania and Montenegro, where we used a top-down model, an IFRS 9 top-down model to identify the unidentified Stage 2 volumes and increased and reclassified volumes from retail Stage 1 to retail Stage 2. You see the results here.

As I explained on the moratorium slide, in many of these cases, like in Bulgaria, Croatia, Serbia and Montenegro, the year-end numbers will not be contaminated, so to say, by the moratoriums, because moratoriums in these countries typically end in September, October. By year-end, we will have a quite good understanding on the intrinsic features of the Stage 2 and Stage 3 ratios in these countries. Whereas in Romania, as I said, the final picture will only be revealed next year when the moratorium ends at the end of the year, so there's some more time there.

In case of the recent acquisitions, like Slovenia, Albania and Moldova, in fact, we have not implemented yet the kind of group level standards, so we still use the Societe Generale IFRS 9 models and migration models, which are also quite good. So, we do trust them, but they reflect a somewhat different methodology than in the case of the other countries. Finally Slovakia, there's less emphasis here, because it's quite likely to exit from our portfolio by year-end.

That's the story behind the Stage 2 ratio developments. I hope this was somewhat helpful. If you look at the Stage 3 ratios. On a group level, it declined from 5.9% to 5.6% and in case of many countries, we see similar type of decline on a quarter-over-quarter basis. Where there's worsening, it's in Croatia, where we see some Stage 3 development already. Given that Croatia is one of the hardest-hit countries out of our portfolio because of high exposure to tourism, it is not surprising.

The following slide shows the coverage ratios. What happened was that in the third quarter, we reclassified certain volumes from Stage 1 to Stage 2 in retail, and we moved their provisioning as well from Stage 1 to Stage 2. Therefore, not surprisingly, we have a decrease in the coverage for Stage 1 and also a slight decrease for this coverage of Stage 2. But altogether, nominally basically, the provision volumes for Stage 1 and Stage 2 together remained the same. The Stage 3 is more or less stable and despite some noise here, there's nothing fundamental happened in case of the Stage 3 ratio.

The final slide in this pack of presentation is describing the situation related to our loan book and the classification into different industries, which we believe are going to behave differently under the current COVID scenario and the high-impact part, which is basically hospitality, accommodation, and so on and so on. You can see the level of exposure for different countries to these industries. It hasn't changed a lot. There are some very minor changes due to the changing portfolio, but fundamentally, it remains the same compared to the second and the first quarters.

All in all, this was the presentation I wanted to share with you. I hope there was some useful information. I'd like to ask you to ask your questions. So please, I'd like to ask my colleague to facilitate this question-and-answer session.

Q&A

Operator

The first question is from Máté Nemes.

Máté Nemes - UBS Investment Bank, Research Division - Associate Director and Analyst - European Banks Research

I have a couple of questions, please. First of all, on the retail stage migration you have mentioned that, for example, in Hungary, this was a bottom-up exercise. You looked at customer ratings and then used these. Could you perhaps elaborate a little bit more on the methodology on these? And then perhaps also clarify whether this also included exposures or loans under moratoria. In this context, perhaps if you could share anything on what you are seeing in account movements or any other kind of data that could give you say additional information on the portfolio health.

Secondly, still on risk costs and credit quality. Based on the macro scenarios that you have shown on Page 22, could you perhaps discuss better the cost of risk outlook for next year? Could it really improve from this year under those scenarios? Or you could potentially see similar performance like this year or maybe even higher?

The third question is on the net interest margin. It seems like this quarter, we are seeing a marked slow-down in NIM erosion, and most of that even came from foreign currency movements. Assuming limited FX movements going forward, could you give us a sense what we should expect in terms of NIM dynamics in the coming quarters?

László Bencsik - Chief Financial and Strategic Officer

The retail stage migration in Hungary did cover all clients, including those who are in the moratorium. Obviously, it was more focused on those clients who are in the moratorium, but it was not exclusively for those. In Hungary, we have quite detailed methodology where we primarily look at account activities, the income to client accounts, and the spending pattern of the clients. In Hungary, we are in a fortunate situation that, for those clients who have a loan with us, we are typically their first banking relationship. Their income typically comes to their account, and they conduct most of their banking activities with us. We actually have quite a broad, all-encompassing picture about these clients' actual behaviour. We look at the account activity, and we try to infer the clients' creditworthiness or rating rather based on these behavioural features. That's what we did in Hungary, and it did include the moratorium clients as well, obviously.

We haven't yet talked about 2021. We are not even ready with our financial planning and budgeting for next year. It would be too early to say anything concrete. Having said that, if we follow former logic, if these macro scenarios prevail, instead of this year's strong negative GDP growth numbers, next year we'll have strong positive GDP growth numbers, then our former logic suggest that maybe we could have somewhat lower risk costs next year than this year.

Net interest margin erosion. Indeed, as you quite rightly said, margin erosion slowed down. It actually turned around in some countries like Hungary, Bulgaria and Serbia. These are obviously big and important countries in our portfolio. What we can say, I think, safely is that this previous fast-declining trend is over. And it's either kind of margin hovering around this level or further small erosion coming primarily from the competitive environment. All the markets where we are present are fiercely competitive, and that reflects in pricing. Typically, new volumes are priced lower than the old book. This effect is there everywhere. But other than that, we don't expect further major shifts in the rate environment in any of the countries where we are, which is quite positive. So, we expect the slowdown to stay with us. We may see further small but rather slight erosion in the future.

Operator

The next question is from Gábor Kemény.

Gábor Kemény - Autonomous Research LLP - Research Analyst

My first question is about the growth outlook, please. It seems that the loan growth accelerated in the third quarter. What's your outlook for the lending expansion for the coming period under your baseline macro assumptions? And specifically, why do you think Russia is an outlier? So your Russian loan book has been shrinking, which is a different trend from what we see at some of your peers. What's your strategy in this market?

And then secondly, a follow-up on the debt moratoria. Can you give us a sense what a share of the -- what amount of the debt under moratoria is being followed under Stage 2? Would the increase in the first 3 quarters be a fair indication?

And then finally, what's the outlook for fee income, do you think? I guess, question is to what extent do you see this business-driven expansion continuing in the coming period? And to what extent do you think the very decent Q3 growth was driven by the pent-up demand as the lockdown was eased?

László Bencsik - Chief Financial and Strategic Officer

Growth outlook, we actually somewhat improved our previous guidance, which was around 7% expected. I would say that it is most probably going to be more than 7%. In the first 9 months, we grew 6%, and in the third quarter, 3%. There might be some slowdown due to the second wave of the COVID. But our assumption is that, most likely, we are going to be above the 7% growth for the entire year this year.

Russia contracted in the first half because the majority of the Russian loan book is very short. Roughly 90% of the book there is unsecured retail loans, and a big chunk of it is actually POS loans. POS loans maturity is less than 1 year typically. The problem is that when demand drops and when sales drop, it almost immediately filters through into volumes. Whereas in a mortgage portfolio, let's say, if a quarterly sale volume is much lower than in the previous periods, you don't quite see it in the stock volume. Whereas in Russia, if we lose one quarterly sales, and this is what happened in Russia because, if you remember, the lockdown there was actually full and long. There was this long kind of extended vacation or bank holiday for Russia back in the second quarter, where the retail outlets were not open, so we could not sell any POS loans. If you have a portfolio where the duration is less than a year and you lose one quarter of the sales, then it immediately translates into the stock numbers negatively. The good news is that when things turn around, the positive impact will be just as immediate as this one. So, this is not surprising, and it's not strategic. This is just due to the nature of the type of the products, that they are very sensitive to demand and actual new production of loans.

The third question was related to the debt moratoria and the stage migrations. In the stage migrations, what we did for retail in the third quarter, was that we tried to reflect the moratorium participation. We tried to simulate an environment if there was no moratorium. This was the underlying purpose of this exercise. We tried to assess or model a situation where there was no moratorium: what would have happened if there had been no moratorium. We will see how successful we were. That's why I elaborated so carefully when these moratoriums expire. Then you can actually expect us to show you actual kind of without moratorium numbers. Because that's when we will see the ultimate results of these moratoriums.

Fee income in the third quarter, this was no surprise. The second quarter was no surprise and the third quarter was no surprise. Because fee revenues are very directly and immediately linked to economic activity, and because underlying economic activity drives transactions: transactional volumes and number of transactions, and these are the 2 most important drivers behind our fee income. When they went down in the second quarter, our fee income dropped. It immediately came back in the third quarter when economic activity rebounded. There might be a slight decline again maybe in the fourth quarter if we end up having lockdowns. I think this is short term. There's a lot of uncertainty. We don't know how far policymakers will go in terms of lockdowns, how far and how long. It's somewhat clear that the tolerance level is much more than was in the second quarter under the first wave when there were quite substantial lockdowns despite the fact that the number of cases were much lower in this part of the world in the countries where we operate than today. I really don't know to what extent the lockdowns will happen. But if they do, then they are going to have, obviously, an immediate effect on our fee income again. But this should be very short term. And as soon as economic activity bounces back, fee income should come back. Then we should actually reach up or go back to the normal level of fee income growth - the rule of thumb is that basically, fee income grows with nominal GDP because nominal GDP is a measure of economic activity. If we have next year 5.8% GDP growth in Hungary and maybe 2% or 3% inflation, that it means that around 9% nominal GDP growth, so 9% fee income growth can happen next year. That's, again, very basic rule of thumb, and this actually applies to any bank in the country.

Operator

The next question is from Anna Marshall.

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

Two questions from me, please. Firstly, on asset quality. May I check in terms of recoveries from your factoring unit in Hungary, how much scope is there for further such moves, i.e., how big is the kind of workout portfolio which remains there? So that was my first question.

And my second question is on dividends. I see you reiterated your commitment to dividend payments. What is the expected time line of communications from the Hungarian Central Bank? Would you expect it to have aligned with the European Central Bank? Or could it move in a kind of different direction and different timing?

László Bencsik - Chief Financial and Strategic Officer

Factoring recoveries - most of the volumes there are not even on balance sheet, so they are off balance sheet numbers. In this quarter, we had roughly HUF 10 billion revenues or positive risk costs coming from this volume. It's not going to go away, it's going to stay with us for a couple of years. The number is going to be less and less, but it's going to be an important and fundamental number for the coming years. So it's not one-off, and it's not short term.

Dividends and the Hungarian National Bank's time line, honestly, I don't have a view on this. I don't know. We are not in a position to inference what they do and when they do it. The current guidance from the Hungarian National Bank is in line with the ECB guidance regarding dividend payments, so no dividend payments till the end of this year. I'm sure they will update it, or they don't see anything - in that case, there's no more restriction on dividend payments. Our fundamental expectation is that we are going to pay dividends. We have a very strong capital position, which is improving. We expect an improving economic environment next year. I mean, from what I can see today, I think it should be possible for us to pay dividends. But obviously, it's up to the Hungarian National Bank, and I'm sure they look at what the ECB does in this respect. Having said that, the ECB did not allow share buybacks for the course of this year. And we were allowed by the Hungarian National Bank to do share buybacks during the summer and the spring. So, we already have evidence that they somewhat diverted from the ECB practice. Having said that, this was very specific, and this was targeted to provide the shares for the management compensation system, which runs in the bank, which is also obviously approved and supervised by the Hungarian National Bank.

Operator

Next question is from an attendee joined via phone.

Olga Veselova - BofA Merrill Lynch, Research Division - Equity Banking Analyst

This is Olga Veselova from Bank of America. I have several questions. First of all, about your M&A plans. You have been really vocal about willingness to do M&A. Yet the regulator loaded capital requirement criteria to support loan growth, not probably for inorganic expansion of domestic banks. How reluctant the regulator would be to approve any M&A until the economic recovery is really explicit? So this is my first question.

My second question is about cost of risk in Russia and Ukraine in the third quarter. You mentioned that the main drivers for recoveries came from a revision of IFRS 9 parameters. What exactly was revised and how sensitive is cost of risk in these countries to these parameters. In other words, if your outlook for 2021 will end up being optimistic, what could be the impact in this region?

And my third question is about certified customer-friendly consumer loans. In your materials, you mentioned that the National Bank of Hungary extends this program, I think, from first of January 2021. Can you remind us, please, what impact this program has on your net interest margin and cost of risk?

László Bencsik - Chief Financial and Strategic Officer

M&A plans. Indeed, we have been quite vocal about our M&A plans. Honestly, I don't have much other than that to say about this, that we are looking for opportunities primarily in the countries where we are present. But we don't exclude entry into new markets either if they are very attractive.

I can't comment on the regulatory response to a potential acquisition. That is obviously their decision to formulate an opinion. We obviously would ask their guidance before we make any commitments, as we always do. It's very difficult for me to comment specifically on this question. What I think is that if our lending activity is strong and if our capital position is strong, and getting stronger, then I don't see any reason why they would not support an acquisition which creates value for shareholders and stabilizes further the group future performance.

If you look at our loan growth, I think it's strong. We have been growing 13% in the first 9 months in Hungary; consumer lending is 33%; mortgages 8% altogether; in small and micro companies 40% growth. We have 25% share in the Funding for Growth Go program. Our market shares are increasing. I think we do everything what we can in order to grow, and we will continue to do everything because acquisitions are important, but they are secondary to organic growth. So, the prime importance is to grow organically, improve our market shares organically and serve our existing clients the best way possible. So, this has to be fulfilled. I don't know to which extent it's the expectation of the regulators. Certainly, this is the strategy of the bank, and that's the management expectation to the institution itself. So I would guess that if you are growing and doing everything in order to fulfil the demand of our clients in terms of lending, and if our capital position is really strong, then I suppose there will be support from the regulator as well. But obviously, I don't know, it's their decision.

Cost of risk, Russia and Ukraine, and what happened there. To sum up the portfolios that we have in Russia and Ukraine, especially the Russian one, as I said, the Russian portfolio is quite short term. It's mostly consumer loans, very granular portfolio, a lot of data. Here, the underlying portfolio parameters guide provisioning to a large extent. Ukraine is somewhat similar because there, we have a growing short-term consumer loan portfolio, and the corporate portfolio is actually also quite short term. At the end of the first quarter, we created extra provisions in anticipation of deteriorating portfolio qualities and deteriorating economic environment. In fact, what happened was that the portfolio qualities remained quite stable. On the underlying portfolio quality level, and again, there are no moratoriums which could introduce distortion in Russia and Ukraine, we actually experienced quite stable portfolio quality despite the severe economic contraction, what we saw in these two countries in the second quarter. Despite this recession environment, portfolio qualities did not deteriorate. And there's no moratorium. So, we had to adjust and look at the assumptions we applied in the models, and made changes. We reduced the extra provisioning in case of Russia and Ukraine, what we created in the first quarter. That's what happened, while the underlying portfolio dynamics is actually quite stable.

Customer-friendly consumer loans. What we have there is margin caps: if the loan amount is below HUF 500,000, then is 15%; above it it's 10%. This is not far from our pricing ranges. The NII impact is maybe slightly negative but certainly not very material. Whereas volume-wise, it might even be positive because somewhat lower rates means somewhat higher volumes, everything else being equal.

Olga Veselova - BofA Merrill Lynch, Research Division - Equity Banking Analyst

And on cost of risk, does it impact cost of risk in any way?

László Bencsik - Chief Financial and Strategic Officer

The lower rates typically mean better clients and lower loan servicing requirements from clients. So, if nothing else happens, then it should actually mean somewhat better risk cost.

Operator

The next question is from Hai Thanh Le Phuong.

Hai Thanh Le Phuong - Concorde Securities Ltd., Research Division - Head of Research

Just 2 topics from my side. So first of all, you said that the other income line had some one-offs, and it was quite high and decent in the third quarter. I'm curious what was the amount of these one-offs? I can't see it in your presentation.

And the other topic is not really related to your quarterly results. It's more on the green products that you have or the NBH is offering in Hungary. So I'm curious whether you participate in this green preferential capital requirement program in Hungary at all. And also, I think in September, there were some talks or articles by the Central Bank of Hungary about the new home program with 0% interest rate for house purchases with renewable energy or green homes. So what's your view on that?

László Bencsik - Chief Financial and Strategic Officer

Other income, we had a one-off in the second quarter. In the third quarter, there wasn't a big one-off. What I said was that in the second quarter, we had a HUF 5.7 billion one-off due to the Visa shares revaluation results appearing in the P&L. And this did not happen in the third quarter. Despite the fact that there was this positive one-off in the second quarter, the third quarter was similar to the second quarter. But in the third quarter, just the underlying performance without any kind of large one-off was better.

Green products. This is certainly strong on our agenda. We have just discussed our green strategy, so to say, this week on the management committee and launched 3 programs under a green umbrella. This topic certainly receives kind of management attention and is strategically important. However, we are at a relatively early stage of development. Very specifically related to your questions, if green mortgage loans can get under Pillar 2, so under the SREP ratio, they can get a preferential treatment. We have to collect a lot of data and provide it to the supervisor. It's related to the environmental rating of the collateral of the residential real estate, and there can be some capital benefit under Pillar 2. But we expect this to be relatively small, and group level the impact will not be material. First of all, I haven't heard anything new related to this statement, which was made by the Governor related to potentially close to 0 interest rate retail mortgages, which was mentioned somewhere during the summer. But as far as I remember, this was mentioned in the context of the European banking sector. So, something like this on the European level should be introduced in order to boost development.

Hai Thanh Le Phuong - Concorde Securities Ltd., Research Division - Head of Research

Okay. Can you share with us, or do you have a figure like what is the amount of mortgage loans falling to this green preferential treatment? Or it's just very small, as you mentioned?

László Bencsik - Chief Financial and Strategic Officer

Again, the capital impact will be very small as far as we understand today.

Operator

The next question is from Thomas Noetzel.

Thomas Noetzel

I just have follow-up questions regarding your mortgages. You made a comment that mortgages are become very popular product not only in Hungary, I believe, but also across the whole CEE region. This would be the product which we are going to focus on, given that there's a demand for that product. Given that also other competitors in the region are targeting these loans, how do you see the pricing of this product going forward in the future, not only in Hungary but in the region? Can you comment anything about your front book pricing against back book pricing at the moment? How do you think competition in the region can impact that and develop in the coming quarters? And would that impact your margin trajectory as well?

László Bencsik - Chief Financial and Strategic Officer

Now for mortgages, it's demand what is strong. Mortgages are always important for a retail-oriented bank like us. What we see today is that, despite the recessionary environment, demand for new mortgages remained quite strong. That is driven by the fact that the real estate sector activity remained quite high, so the number of transactions, and residential real estate prices continued to grow in most of the markets where we operate. And in a way, this was not obvious to expect. Strategically, we don't put more focus on mortgages than we did a year ago. It's equally important. It's just that there's continuously high demand for mortgages. Whereas for consumer loans, in some countries, we have seen a quite sharp drop in the demand itself.

Now talking about pricing, as I said when I elaborated on margin expectations, price competition is strong everywhere in every product. Potentially the strongest in large corporates where we see, in some countries, exceptionally low rates. Especially in case of the Eurozone countries, Slovakia and Slovenia, we see quite a price competition for mortgages as well. So in our view, and in some cases, especially in Slovakia, the price levels reached a point where I think it's questionable that it makes sense from a lender point of view to continue the business. That's one of the reasons we are exiting the country, by the way.

Price competition is strong in every segment, in every country, basically because the banking sectors are typically very liquid and well-capitalized. In this part of the world, you can still make margins. You can still make decent returns on basic commercial banking activity. And therefore, all of our competitors are eager to grow in these markets. It's not just in mortgages, it's also true in the other product categories. Sometimes, it's even more true because if there's less demand for a certain product, there's less new volume, then competition can even increase compared to another product where there's increasing demand. Therefore, it will continue to exercise pressure on our margins. So, some slight moderate margin erosion can be expected just coming from price competition in basically in every product in every market.

Operator

The next question is from Alan Webborn.

Alan Ramsey Webborn - Societe Generale Cross Asset Research - Equity Analyst

My first question was on costs. Do you think the 9 months cost increase at the group level is indicative of what we'll see over the full year? Or have you been sort of quite cautious in terms of sort of costs and investment progress and so on in a more difficult environment? I just wondered whether there's always some increase at year-end, but how do you feel about that in the current context? That was the first question.

The second question was, do you now have a sort of a better more granular view of what the new moratoria in Hungary will look like? I think you've suggested in the past that maybe 1/3 of the clients that were involved with previous moratorium will be in the new one. Do you still stick with that? Because I think you were still waiting to get some details of that plan. So if there's an update on that, that would be useful.

And then just a little bit of a clarity in what you're doing in Romania. Is what we're seeing a one-off cost jump and then things will calm down a little bit next year? I mean, clearly, you were looking to get Garanti’s business there, and you didn't get it. So just to give us an idea of what your game plan is at the moment in Romania, that would be great.

László Bencsik - Chief Financial and Strategic Officer

Costs. We had FX-adjusted without acquisition 3.4% year-on-year growth in the first 9 months. Usually, year-ends are seasonal, so there might be some increase in the fourth quarter in costs. But that happened the year before and so on and so on, so in this sense, it's a usual seasonality. Therefore, I hope that the annual growth will not be far from this number what we have seen in the first 9 months. It's clear that in these relatively difficult times, importance of cost efficiency increases and our attention to costs kind of increases. We don't have any more yet. The remaining mergers will start to yield their benefits later, so it won't happen this quarter. As I said, Montenegro is going to merge by the end of this year, and Serbia somewhere in the first half, probably in the second quarter of next year. And here we actually expect a bigger cost synergy, just because of the size of the Serbian entity. But that will only come next year somewhere in the fourth quarter, so it's too early for that to manifest.

New moratorium participation. I can't recall that I said that it was going to be 1/3. It's clear that we expect less than what we have today. But I don't think we have given any concrete guidance on how much we expect. The retail eligibility criteria are quite broad, so someone who has a child or pensioners or self-employed, so that's a relatively broad category. A bigger difference can come in corporate because the current moratorium was an opt-out structure for corporate: everyone qualified, and they had to ask for not being part of the moratorium. Whereas it will be very different for the next phase where they actually have to prove that they are eligible and their revenues declined. So that will be a potentially bigger drop in corporate than in retail. But we don't know yet. We don't have a specific guidance on the expected participation other than that it's going to be less.

Romanian game plan. Unfortunately, this prospective acquisition fell through. Therefore, we were left with our underlying organic growth strategy, which we started to execute the beginning of last year. We changed the management team, and we put the whole bank on a new organic growth trajectory. So, this is what we are doing, and this requires investment: we are basically hiring new people, developing IT systems and so on and so on, in order to provide a more robust value propositions to clients and to have more organic growth. Our market shares are growing, so in a way, this works. Certainly, there's much more dynamism there organically than used to be. Having said that, even from where we start, so it's less than 3% market share, it's very hard to imagine how we can get organically to the required level of market share. Therefore, despite our organic growth efforts, we still keep on our agenda further acquisitions in Romania. So, that would be strategically potentially the most important. Having said that, there's limited supply of assets, let's put it this way.

Operator

The next question is from Simon Nellis.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

I have a question related to Alan's question. Can you give us an indication of what kind of integration costs, further acquisition effect costs you expect in the fourth quarter, maybe into next year and beyond. I guess a lot of this is kind of restructuring costs or integration costs. So should we expect these hits to kind of come back through the cost line going forward? I mean, this year, you look like you'll have negative jaws, but can you give us any steer on the outlook for costs next year and whether you can actually grow revenues faster than costs next year?

László Bencsik - Chief Financial and Strategic Officer

The integration costs, in the third quarter, it was roughly HUF 5 billion. Once we finish the merger projects, notably the Montenegrin and the Serbian ones, this number should get to a much smaller level. There will be a remaining part, which is the amortization of what we call a part of the goodwill, the customer base value adjustment, what we had to do at the time of the acquisition. There's this amortized value, which stays with us for some years after a given acquisition. And for different acquisitions, what we have done there were different amounts related to different portfolios. So that's a bit complicated. But the bottom line is that, once we have done in Montenegro this year and end of first half next year in Serbia, then you should remember this HUF 5 billion number should get much less.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

So you're saying there'd be another HUF 5 billion in the fourth quarter?

László Bencsik - Chief Financial and Strategic Officer

Yes.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

And then another HUF 5 billion every quarter until you complete the Serbian deal?

László Bencsik - Chief Financial and Strategic Officer

Less than 5 because once Montenegro is completed, then we should have less.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

I see. So going into next year, it should be a lower quarterly figure.

László Bencsik - Chief Financial and Strategic Officer

Yes.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Got it. Just on the cost of risk. I mean, what's your thinking, like, say, 2 years out, what is a normalized cost of risk with the larger footprint that you now have? Can you give us any indication there?

László Bencsik - Chief Financial and Strategic Officer

Yes. Probably around 50, 60 basis points.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

50, 60 basis points. Okay. And then my last question would just be on risk weight density. I saw that it declined a bit in the quarter. Is that expected to continue? Or where do you see risk weight density trending over the next year or two?

László Bencsik - Chief Financial and Strategic Officer

This year was very special in terms of the composition of the portfolio because mortgage volumes continued to grow fast. And then especially the Russian consumer loan portfolio, which has the potentially highest risk weight within the group declined substantially. And a big chunk of the Hungarian consumer loan growth is related to the baby loans, which have virtually 0 risk weight because they are 100% state guaranteed. So, this is the kind of composition: the type of growth we had during the course of this year, mortgages and the baby loans in Hungary, they have much lower risk weights than the group average. The highest risk weight, what we have is the Russian one that was actually negative. The other factor was that government securities portfolios increased. Again, this is another asset category which has a very low risk weight. And there was this SME adjustment, that's the new regulation on EU level, SME loans get a slightly lower risk rate. That also contributed.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Okay. But it sounds like if the Russian lending kind of picks up, then probably risk weight density stays stable or even rises going forward.

László Bencsik - Chief Financial and Strategic Officer

Yes.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

And then the last question on the dividend. I mean, I think you made it clear that the dividend deduction shouldn't be seen as an indication of what you might propose. So I guess, just in terms of the messaging, you're saying that you'll definitely try to pay out something if you're allowed equivalent to the HUF 69 billion that you proposed for 2019, and then on top of that, something else, right?

László Bencsik - Chief Financial and Strategic Officer

Exactly.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

And I mean, what kind of capital ratio do you think the regulator wants you to have at the end of this year? Is there any kind of level?

László Bencsik - Chief Financial and Strategic Officer

The requirement, in terms of Tier 1 ratio and also Common Equity Tier 1 ratio, in our case these are the same because we don't have alternative or Additional Tier 1, so the regulatory requirement, including the SREP ratio in Pillar 2, is 9.7%.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Yes, I mean you're well above that. So I guess, how much of a buffer do you think you need for the growth prospects for potential M&A?

László Bencsik - Chief Financial and Strategic Officer

I mean, years ago, we said that we target 15%, and the kind of acceptable range is between 12% and 18%. So, we could go down to 12%, especially now that the regulatory requirement temporarily decreased because the Other Systemically Important buffer was temporarily reduced to 0. Certainly, the lower part of this range seems to be finer today than a year ago. But I don't know, I mean, this is obviously decided by the regulator.

Operator

The next question is from Andrzej Nowaczek.

Andrzej Nowaczek - HSBC, Research Division - Analyst

I have a couple of follow-up questions on costs. You may have answered them already one way or another, but I'll still ask them. First, are there any reasons why this year could be different when it comes to the usual cost seasonality in the last quarter?

László Bencsik - Chief Financial and Strategic Officer

There will be some seasonality as usual, but we will be especially cautious, as much as we can, not to spend anything which is not absolutely necessary. So, I think there will be seasonality, but maybe less than in previous years.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Okay. And then I noticed that your headcount numbers started rising again in Q3. Does it mean that most of the restructurings have been done, I mean, in those places in which you made acquisitions?

László Bencsik - Chief Financial and Strategic Officer

In Montenegro and in case of the second acquisition in Serbia, the merger projects are still ongoing, and we have not started to realize the cost synergies, the headcount synergies. Where they have been realized, it's Croatia and Bulgaria, because in Bulgaria, we finished the merger. In fact, there, we started to recognize headcount synergies much earlier, already last year during the merger. But there's potentially some more expected in Bulgaria.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Okay. And lastly, on COVID, would it be fair to assume that last time you updated your risk management models was before the second wave of COVID became the reality. And is it therefore likely that you'll have to top up your COVID-related buffers in Q4?

László Bencsik - Chief Financial and Strategic Officer

That's difficult. I think we will try to be as conservative as possible under the accounting rules. If you look back previous years, this has also been a kind of pattern that year-end we tried as much as we could to be conservative. We are going to do that this year as well. To which extent it will be exactly related to this wave of the COVID, that's not as obvious because if this wave is done by year-end, and we run the models in January, and if there's a relatively severe wave in November/December, then by January, we already see numbers improving, and there's also vaccine starting to be available in Europe. The GDP growth expectations for next year will be at least as good as what we presented today. Then, there's no need to include more pessimistic scenarios in the forward-looking models. But it can play out differently as well because if this wave of the COVID is deeper and longer, and there's no vaccine in sight and so on, then we would have obviously somewhat different expectations, somewhat worse expectations. I think the best we could do was the slight tweaking of the guidance, that instead of around 125 basis points, we suggested that maybe the credit risk cost rate will not be more than 125 basis points. So this basically summarizes, as much as we could, our expectations for this year.

Operator

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

László Bencsik - Chief Financial and Strategic Officer

Thank you very much for joining us today and listening to the presentation. And thank you for your very good questions. I wish you all the best, good health, most importantly. So take care of yourselves. I hope we will all get through these difficult times. And when we meet next time, early March, when we present the results of the full year, I hope by then, most of these problems will be behind us. But until then, take care. All the best for you. Goodbye.

Operator

Thank you for your participation. The third quarter 2020 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.