OTP BANK
2Q 2021 Conference call Transcript

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PRESENTATION

Operator

Dear ladies and gentlemen, welcome to the OTP Bank Second Quarter 2021 Conference Call. This conference will be recorded.

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

László Bencsik - Chief Financial and Strategic Officer

Thank you. Good morning or good afternoon, depending where you are, and thank you for joining us today on OTP Group's 2021 second quarter Interim Report Conference Call. It's a pleasure to have you here in the middle of the summer. Thanks for all of you who decided to join us today. As usual, the presentation has been available on the website for a couple of hours.

Basically the second quarter was in line or slightly better than our expectations in many ways. That obviously reflects in the adjusted after-tax profit of HUF 129 billion in 2Q, which is one of the highest ever. This actually led to HUF 246 billion profit in 1H altogether.

Probably the most interesting factor here is that in the first half of this year, we actually managed to increase the contribution of the foreign subsidiaries to almost 60%. If you look at this page, the contribution from non-Hungarian entities was 58%. There hasn't been any big one-offs in this number for the first half. That means that actually we achieved a situation where our foreign entities have more than 50% contribution to overall profits and that is a result of the acquisitions that we have done over the years which created a more diverse and distributed group in terms of geographies.

There was one meaningful or sizable one-off item in the second quarter, and that was related to the extension of the moratorium. This amounted to HUF 5.6 billion after-tax and just to remind you, this is the result of extending the moratorium in Hungary from the end of June till the end of September.

If we go further, here you can see the P&L composition. The fact that the profit more than doubled compared to the first half of last year is obviously not a surprise given that the risk cost was driving both periods. As opposed to booking more than HUF 130 billion risk cost last year in the first half, this year it was only HUF 18 billion. That caused the biggest difference in earnings overall. If you look at the different lines, I think it's quite positive to see that after all the adjustments and we really compare apples with apples, then the operating profit without one-offs and without risk costs obviously increased year-on-year 18%, and this is comparing exactly the same methodology and exactly the same group members year-on-year, whereas revenues increased 11%. Obviously, part of it is volume growth related, primarily the interest income part. The good thing is that the fees and commissions also recovered. You probably remember that last year, it was a more sluggish line in revenues that together with the COVID situation and its negative impact on economic activity we had somewhat lower fee income last year, but that quite nicely recovered this year.

On a quarterly basis, we also made quite a progress. On the fee line, especially 12% increase, but also net interest income held up quite nicely, and that is obviously linked to the volume growth and the stabilizing margins that we have seen.

If you look at the results country-by-country then, basically, we have the same improvement everywhere due to lower risk costs, but just to highlight few countries: in Serbia you can see the nice results we had in the first half especially compared to last year, Russia recovered very nicely in terms of earnings and return on equity, and this goes together with Ukraine in terms of profit contribution; Ukraine has been also very strong.

In each country, I think we can be quite happy with the results, including Romania where the actual net income is somewhat modest. Just to remind you, here we are in the middle of a strategic transformation process where we are investing into the organic growth of the bank, and that actually resulted in larger increase in costs in the first phase than in revenues. We do believe that this is the right path to take and to try to gain market share and reach a higher and better economies of scale in the country.

If we go to page 7, it is about the net interest income dynamics. As you can see, some countries like Hungary were particularly strong, obviously due to the strong volume growth, but also the stabilizing margins or already slightly increasing margins. Ukraine, extremely strong due to, again, volume growth. Where we have actually negative numbers, these are, on one side, Bulgaria, Croatia and Slovenia, these are the either Eurozone or close to the Eurozone countries in the group where we still see a very depressed margin situation. And Russia, obviously, due to the lower volumes as we discussed it before: we probably have been somewhat more conservative than
we should have been, and also more than probably the market, therefore, we had lower volumes last year. Nevertheless, the profitability is actually quite good in Russia due to the very low risk cost because of this very cautious lending activity we had last year.

On page 8, you can see one of the good news, that now we have 2 quarters when the net interest margin stabilized on group level. It started in the first quarter and now for the second quarter had the same impact. We have obviously Hungary, where the rate hike started and we are in an increasing rate environment now, also that's the case in Russia and Ukraine. This is obviously helpful to stabilize the margin. Having said that, it's still not a spectacular growth. It's rather stabilization of the margin environment.

If we turn our page to the volume dynamics, then on a quarter-on-quarter basis, you may remember that the first quarter was less than 2% growth. The second quarter really accelerated, and we had 5% growth, which is quite strong across the board, some really good numbers like Ukraine where corporate lending this year was extremely good. Hungary, 7% growth, also Bulgaria 4%, Croatia 3%. Slovenia 4%, Romania 5%, and these are just quarterly numbers, not annualized, but just in one quarter.

If you look at the first 6 months, then we have 6% growth group level and 10% in Hungary. On this slide, we expanded on our previous guidance and said that based on what we have seen in the first half of this year, assuming that these trends continue, we expect group level volume growth to be stronger than 10% this year, so we expect a decent double-digit growth rate in performing loan volumes.

We believe that the Hungarian dynamics will continue, and also in other countries. Additionally we really expect Russia to start the engines in the second half of the year, and hopefully, we should see the usual seasonal growth in the second half, especially in the fourth quarter in terms of volumes. Again, on this slide, we updated the guidance, and now we expect more than 10% growth.

Deposit growth somewhat slowed down, and this is something we are actually quite happy about. The second quarter has been the first quarter for a long time when loan growth exceeded deposit growth. Group level we have 77% net loan-to-deposit ratio, which is obviously suboptimal, so it's not a really efficient balance sheet. We hope that a new trend is starting with this quarter and in the future, we are going to see higher nominal growth in loans than in deposits.

If you look at the first 6 months in deposits, then it's +4%. Thus in the first 6 months, you can see that the nominal growth in loans was still higher than in deposits, the same as in the second quarter.

In terms of fee income, again, this is a line where we see a very strong recovery compared to last year and even on a quarter-on-quarter basis, there's a very good dynamic, so 14% and 12% respectively, in almost every country. In some countries, this is more related to the transactional activities, elsewhere rather to increasing lending activity. Basically, across the board, we see a very strong momentum on a quarterly and also in most cases on a yearly basis. So, fee income is catching up to the previous trend line or to the previous normal.

Other income quarter-on-quarter, there wasn't overall a lot of movements. We had some FX loss in Hungary, but that wasn't substantial. Overall, this is a line which on a year-on-year basis resulted in 40% growth across the group.

In terms of costs, we made here a methodology change. We reclassified the local taxes in Hungary to corporate taxes. They used to be in OPEX, but we learnt from our new auditor that this is the practice of other banks in Hungary, so we followed the crowd in the sense. We also believe that this change makes our numbers more comparable to any benchmark you might want to look at. On these adjusted lines, year-on-year, we had 3.1% cost growth.

If you look at some of the entities, you actually see year-on-year decrease in case of Bulgaria, Serbia, and Montenegro. These are the countries where we recently finished the mergers, so there are still cost savings coming from the merger. Serbia is something to look at, because here we just finished the merger of the second acquisition in the second quarter this year. This is the country where further sizable cost synergies are expected to come in the future. As I flagged it before, you see Romanian costs growing 29%, and this is what I refer to as our organic strategic investment into our activities there.

A few more detailed slides and information on the Hungarian activities, we are actually quite happy with the results. We believe that, ultimately the best measure of performance is market share and the market share trends, whether it's growing or decreasing. As you see, we are basically at historic highs in terms of market share in new mortgage production, in new cash loan production, and in household savings. They all increased. They are maybe not at
historic highs because in the 90's OTP was even more dominant in the market, but clearly, for the last 15 years, these have been the highest levels of market share.

If we go further into details here, this is partially due to the fact that we have been very active in channeling the different type of subsidized structures which are available to retail clients in Hungary. In all of the structures we have quite high market shares, even higher market shares than usually in other product categories. That is obviously related there to the level of trust and also the accessibility and the availability of OTP having this very dominant multichannel coverage of the market in Hungary. We're still very much live and operational with strong branch network that we have across the country.

We have a similar situation in corporate as well. Our market share this year continued to grow. If we take a longer historical perspective here and compare to, let's say, 2008, 7.5% as has been only organic, here we have 2.5x higher market share than we had 13 years ago, and it has all been achieved organically.

In the specific structures, subsidized either by the Central Bank or by other means in Hungary, we tend to be very active. We had 28% market share in the Funding for Growth Go! program, which was designed to mitigate the negative impact of the COVID situation, especially last year and first half of this year. We have also been very active in micro and small corporate lending to Hungarian companies with 26% growth year-to-date, and this means that the trajectory, what we created last year actually continued.

This relatively strong volume dynamics compared with at least the last 6 months with very modest portfolio deterioration or if you look at the Stage 3 ratio, it actually declined. Obviously, the reason for the decline is the increasing denominator. But nevertheless, we are down to 5.4%.

There wasn't so much change in the Stage 2 ratio during this year. Also the coverage is more or less stable. We do believe that we have been quite conservative in our provisioning: if we compare our coverage ratios in Stage 3, the nonperforming category, or in Stage 1 and 2, which is practically the performing portfolio, to some of the other regional players, then we can see that it actually has been reflected in the numbers.

Moratorium was a big thing last year. It's still a big thing in Hungary, but not in any other markets. So in all the other markets, the moratoria have been phased out, closed down. I can safely tell that all the potential ramifications, negative and positive, have already built into the portfolio qualities that we can observe. The only exception is Hungary when I started the presentation, I said that it was even extended from the end of June until the end of September. Participation is down to 28%. It is higher in retail, retail is 39% and corporate 15%, and it's still in the opt-out structure, so everyone is in the moratorium unless these retail or corporate clients don't ask for not being part of the moratorium.

This resulted in one-off losses that we booked, which relate to the time value of money, so in a way it's not a nominal revenue loss. It's a time value loss that we have duly booked. We continue to monitor the underlying portfolio quality very closely. We have loads of information about these clients in Hungary in terms of their behavior characteristic, and we continue to monitor them and rate these customers according to their behavior characteristics and we regularly update, therefore, the Stage 1, Stage 2 and Stage 3 classifications.

Potentially the last subject is the equity. We managed to further improve our capital position, the Common Equity Tier 1 ratio, which in our case is the same as the Tier 1 ratio, was at 15.9% at the end of the second quarter. The other related news is that, we’ve been part of the EBA stress test together with other 50-ish European banks, and we were number 12. It's not a competition, but nevertheless, we were quite content to see that in terms of the 3 years impact under the adverse scenario on the capital adequacy ratio, we were the 12 lowest. That reassures us that as much as the ratios, which are high, but the underlying resilience of the business model to external shocks is actually quite strong in European comparison.

Some highlights about the macro expectation. We obviously expect this recovery to continue throughout '21. Even if there is another potential wave of the pandemic situation, we believe that it should not disrupt fundamentally the growth momentum what we have built, especially in lending. Maybe just a reminder that this very strong 5% quarterly volume growth actually happened in a quarter when especially in April and May, the COVID situation was actually quite strong and quite serious, especially in Hungary. Despite of this relatively stressed pandemic situation, we actually saw quite active business activity and increasing demand for loans.

Finally, the guidance update. As I said, we updated the expected loan growth above 10%. We also became more specific on the ROE guidance. We used to say that we expected it to be higher than last year, but now we are more specific. We expect the adjusted ROE to be somewhere between 18% and 20%. That's also probably not very surprising because the first half result was 19.1%. This is pretty much in line with where we are at the
moment, where we were during the first half of this year. Obviously, that implies that we expect the risk environment to be largely similar in the second half of this year to the first half.

In terms of dividends, the HUF 119 billion after '19 and '20, it remains deducted from our regulatory capital. We intend to pay this out to the shareholders. Also in line with the EU regulations, we calculated for the first six months HUF 42 billion dividend, which we deducted from the regulatory capital. So altogether, we had HUF 161 billion deducted from our regulatory capital and capital ratios at the end of June.

I think that's it. I tried to be succinct this summer. I'm sure you have very good questions, so probably I will have some opportunity to further elaborate. So please, operator, open the floor for questions.

**QUESTIONS AND ANSWERS**

**Operator**

The first question is from Andrzej Nowaczek, HSBC.

**Andrzej Nowaczek - HSBC, Research Division - Analyst**

I have 2 or 3 questions. First I guess the acquisition of NKBM will dilute your ROE next year, plus you're generating so much capital that it will be difficult to sustain the current ROE anyway. So just a usual question, is there a big acquisition around the corner? What are your thoughts on a dividend outlook beyond that HUF 119 billion?

**László Bencsik - Chief Financial and Strategic Officer**

Yes, the NKBM will somewhat dilute the group level ROE, but also it will dilute the cost of equity, it's clear that those things go together. Lower cost of equity, lower expected return environment, we achieve lower ROEs, but if the ROE is visibly higher than the expected return, then I think we do a good job. That goes in line with the risk profile of the group as well. If we expand in the Eurozone country, which is actually quite stable and has a quite strong development path, then that's a different risk profile than some other group members. I think that's perfectly okay.

In terms of acquisitions, there's nothing more I can report, nothing concrete, other than we continue our efforts to secure further acquisitions, which deliver value for our shareholders and also for the clients we serve. Obviously, in case of NKBM, the deal has been struck, and now we are waiting for the ECB to approve the deal. We expect that to happen somewhere end of first quarter, beginning of second quarter next year. Further acquisitions, we usually do not talk about any concrete developments until it is real, so I’d like to keep that custom.

In terms of dividends, the HUF 119 billion amount is related to 2019 and 2020. The suggested dividend for this year will be defined at its due course. I don't think I can say much more at this moment. The amount is HUF 42 billion. This is according to the specific formula, which must be applied when a bank counts the interim profit into its capital ratios in case there's no approved dividend policy, and that's our case. I think that's the answer.

**Andrzej Nowaczek - HSBC, Research Division - Analyst**

On costs, well, congratulations on your performance in H1, but are there some cost adjustments to be expected in the second half, such as salary hikes, some extra bonuses in December, just more spend on marketing and advertising?

**László Bencsik - Chief Financial and Strategic Officer**

The good thing about recovery is that there's increasing demand and increasing lending activity, more transactions, higher fee revenues. The answer is that inflation actually increases. In fact, the labor market tightness is back to the pre-COVID level. We have to follow that, and we have to remain competitive in terms of wages what we pay to our colleagues in order to have the best talents. So, yes, personnel expenses are going to grow, and we are increasing wages during the second half of this year. That's correct.

These are the 2 sides of the same coin. Higher activity, more loans, more fee revenues, even maybe some more supportive rate environment due to higher inflation, but on the other hand, much bigger pressure on the cost side. Therefore, we tend to look at is the cost-to-asset ratio, and then if we even compare to last year, I think we have achieved quite an improvement, but also in the cost-to-income ratio. Now the cost-to-income becomes more
and more meaningful now that the revenue margin seems to stabilize. That's potentially another metrics which is meaningful when comparing different periods.

But nothing else, we don't have any big one-offs coming other than the fact that you just mentioned that we have to follow the labor market trends and adjust the salaries of our colleagues.

**Andrzej Nowaczek - HSBC, Research Division - Analyst**

Very quickly, if I may. On Russian loan growth specifically, are you not concerned about the impact of the recent risk weight hikes on consumer loan growth in the second half and into 2022?

**László Bencsik - Chief Financial and Strategic Officer**

No, in a way that we can theoretically improve competitive dynamics and maybe even pricing. We're quite happy to allocate the necessary capital to the activity there. In fact, we are well over-capitalized in Russia. We actually have lower loan volumes than a year ago. This is not a concern for us. The question rather is whether this is still a dominant sales channel, i.e. the physical POS and our cross-selling engine of credit cards and cash loans that has built on the customer base acquired primarily through the physical POS channel. This is clearly not the highest growth segment of the market. Most of our efforts are directed at the moment to somehow try to capture more new businesses from other sources rather than the physical POS. Those are the strong strategic initiatives that we pursue at the moment. I hope that they will work, and I hope that we can actually get back to the expected level of loan growth because, again, last year we were probably too conservative in our lending, which resulted in quite a material decline in the portfolio.

Having said that, short term this is obviously very good for profits because it's also resulted in a very good portfolio quality. In terms of returns and nominal profit, it's actually quite a good year, but we believe that we left some money on the table, and we did not fully capture the potential in the market. Honestly, we hadn't known a year ago, how bad potentially the COVID situation can develop in Russia.

**Operator**

The next question is Hai Thanh Le Phuong, Concorde Securities.

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

Just on the risk cost topic. Coming back to Russia, you said that risk cost was quite low in the first half of the year. I think you already mentioned because of the asset mix. Does this mean that in the coming quarters or next years, we should expect a lower through-the-cycle cost of risk and how much will it be? My second question is also on provisions. I saw that underlying risk costs was basically zero in the second quarter, but other provisions were rather high compared to the previous quarters. What items were under this line, if you could elaborate on that?

**László Bencsik - Chief Financial and Strategic Officer**

The Russian risk cost rate, if that was your specific question. It ran down to 2%, I think we haven't had such a low rate ever. In reasonably good years, we had between 5% and 7% risk cost rate in Russia. We think that the 2% is probably too low. Once we get back to the optimal volume growth and optimal lending level, then it should go higher in order to maximize the return.

At the moment, we think that it's not going to go up to this 5%-7% level, maybe it will remain below 5%, but certainly higher than the 2% that we have at the moment and which is the likely number for some more period until we see a bigger loan growth in the second half of the year.

The other risk costs are related to provisions we made for legal claims, and some off-balance sheet risk we covered. It's coming from all over the place basically.

**Operator**

(Operator Instructions)

**Nida Iqbal - Morgan Stanley - Equity Analyst**

I have a few questions. Firstly, on the cost of risk, it's been of course very low in the first half with positive risk cost in Hungary. How should we think about the trajectory looking into 2022?
László Bencsik - Chief Financial and Strategic Officer

Last year, we provisioned quite conservatively, or rather what happened was that we quite conservatively increased the Stage 2 volume. We classified a lot of loans into Stage 2. We have not reversed these classifications. They are still in Stage 2. The extra provisions we created last year are still there. If the situation continues to improve then at some point these loans, which are now at Stage 2 will continue to perform. Then at some point, we will revise this classification, and we classify them back to Stage 1, which will ultimately result in some provision releases.

Assuming that the recovery continues and there won't be a turn-back or fallback or whatever, then at some point or maybe not at once, but more gradually, but certainly during the course of 2021, we should see some positive effect coming from reclassification back to Stage 1. So that's one element.

The other element is just the underlying risk environment, which at the moment is quite positive and supportive. Honestly I don't know how long this is going to last. At the moment, there's no indication when it should end. If you look at our GDP growth expectations, they're typically around 5%, next year similar around 5%. We expect a very positive environment and relatively fast-growing economies. Sooner or later, the COVID situation will end and some of the specific industries which were hit hard, like foreign tourism to Hungary for instance, which is still very low, these are going to come back, and they're going to provide further boost and further demand for loan growth.

In our best estimate, the best we can say is that for foreseeable future, we expect continued strong economic activity. Therefore, in that environment, we expect lower risk cost. Maybe not 14 basis points, but just to remind you, in '19, so pre-COVID, we had 28 basis points risk cost. In '18, we have 23 basis point risk cost. I don't see why we would not be in that ballpark level where we were in '18 and '19, if we are going to have a similarly growing economic environment. I know it was a long answer to a short question.

Nida Iqbal - Morgan Stanley - Equity Analyst

It was very helpful, thank you. Then just one question on the recent rate hikes that we're seeing in Hungary and expectations that this will continue. Could we get some color about your sensitivity to the higher rates and how you see NIM evolving into next year again?

László Bencsik - Chief Financial and Strategic Officer

Well, we have already seen a lot of movement in activity for a number of years. The base rate is now at 120 bps and further hikes are expected. The sensitivity at this level is certainly lower than 60 basis points before where we started this year. Another 10 basis point would translate into potentially around HUF 0.5 billion annual NII increment in Hungary. So we would still gain from further increases in the rate environment.

There's increasing uncertainty because if there are further rate hikes, we are entering into territory where potentially deposit rates might start to grow. This inflection point is relatively difficult to model. We will still benefit marginally from further rate hikes, even short term, and long term obviously that's even more the case.

The overall impact on the NIM should be positive, obviously, in Hungary, but also on a group level. In the second quarter, not much of this is actually visible yet, because typically the repricing takes 3 to 6 months of the variable loans what we have, where really most of the impact comes through. In the second quarter, you could not fully see the impact of the rate hikes so far. The fully phased-in impact of what happened so far in Hungary will be visible in the first quarter next year.

Therefore, certainly the Hungarian NIM should improve. That should have a positive impact on the group level as well. It's not just Hungary, it's also Russia, Ukraine, where we have increasing rate environment. I think I'm getting more and more confident in saying that it seems that this long period of decreasing NIM is over. Then hopefully, we are getting into a different world, much smaller magnitude, but visible improvement in the Group NIM can and actually should happen in the future.

Operator

(Operator Instructions)
Olga Veselova - BofA Securities, Research Division - Equity Banking Analyst

Hello, this is Olga Veselova from Bank of America. Thank you very much for taking my questions. I have several questions today. One question is do you stick to your interest, to your plans to consider M&A in Asia? My other question is again about Russia, what loan growth would you expect for your Russian business in the next 1-2 years? Also when you were speaking about Russian business, you mentioned that you may try to capture more businesses from other sources rather than the point-of-sale lending. Do you mean that you will consider other types of lending, so the consumer lending, not just point of sale? Or you mean non-lending businesses? So what exactly do you mean there? My third question is big picture question. We noticed quite a bit of difference in the tone of Hungarian banks, not only OTP, but banks overall and the regulator. Banks sound quite upbeat, but the regulator extends payment moratorium. It extends dividend ban. It said that the credit risks are elevated when it published its midyear financial stability report. Why do you think is that? What makes the regulator staying still conservative? Overall on the dividend limitations, what is the rationale for the National Bank of Hungary to stay cautious and extend the dividend limitations?

László Bencsik - Chief Financial and Strategic Officer

Okay. M&A, Asia, I think it has been clear that we have been exploring opportunities in Uzbekistan. We continue to explore those opportunities and our efforts may come to fruition. We find this country extremely interesting, very early development phase in terms of the banking sector and young and fast-growing population, and in general a strong drive to modernize the country. Seems interesting, but we'll see. So there's nothing concrete I can talk about.

The other story which we have talked about was maybe doing something in China in terms of consumer lending. It's still on the table that we may enter a joint venture with some local players. But again, there's nothing concrete I can talk about. The potential size of the transaction would be much smaller in China. From a group perspective, the amount of potential investments we are talking about here is not big, but nevertheless, quite interesting. The Chinese market is extremely advanced and developed in terms of consumer lending. This is something we believe we should be part of it to at least see it from close what happens there because there's an incredible service innovation and digital innovation going there. In many sense, I think they are years ahead of what we have in general in Europe. That's certainly a very exciting environment, but if we do something, we're going to be quite careful and modest with the bets we take. But again, there's nothing concrete at the moment I can talk about.

Russian lending and diversifying. What I said was that we have quite high reliance on physically distributed POS loans through physical agents. This is the segment which is not growing. The online POS segment is growing. So the obvious way to diversify is to increase our share from the online distributed POS loans, and from other online distributed consumer loans primarily, but we started to be active in car lending for instance in Russia, and that's actually growing quite fast, obviously from a very low base in our case. We have some other ideas, which I hope will work out and surprise the market. It's not fundamentally changing the business model of the bank. It's just strengthening the focus of other sales channels of existing products other than the physical POS channel, especially during the COVID situation. This COVID situation overall, not just Russia, everywhere, accelerated digital adaptation and therefore accelerated the move of customer spending from physical outlets and shops to online, and we have to follow that.

This is something we haven't been as strong and fast so far as we should have. So this is something we are working on very heavily to improve. That was the comment I made on Russia. So we are not going to be an investment bank, for instance, in Russia. We are not moving away from the current scope. Having said that, corporate has always been part of our business there, but this is usual corporate banking.

The regulator, you asked me about my comments on the view of the regulator, I'd rather not do that. It gives me comfort if the regulator and the supervisor is conservative and considers potential negative scenarios. I think that's what they should do in order to protect the financial sector. Having said that, I don't know any fundamental reason why this is the case other than general concern about potential ramifications of the COVID situation, but we don't see that neither in loan demand, nor in the quality of our portfolio. I don't know whether they see something which we don't see. They certainly have not told us. But I think it's perfectly okay, I think it's actually quite good that they are concerned and try to protect the market. I think that's what they should do.

We have gone just through this stress test. We can always argue that the methodology is good or not. We think that the methodology of the stress test is extremely conservative and then under this conservative stress test conducted by the EBA, we did quite well. I think that's another objective external view on the potential risk of our portfolio. So we feel confident. Lastly, the fact that the regulator is not overoptimistic, I think that's perfectly fine.
Operator
The next question is from Gábor Kemény, Autonomous Research

Gábor Kemény - Autonomous Research LLP - Research Analyst
Firstly, a clarification. I seem to have made your estimate for the Hungarian rate sensitivity. Can you just repeat the number, please, 10 basis point increase implies how much additional NII?

László Bencsik - Chief Financial and Strategic Officer
HUF 0.5 billion per year.

Gábor Kemény - Autonomous Research LLP - Research Analyst
HUF 0.5 billion, understood. Yes, the other question would be on the Hungarian loan growth. You are flagging a retail loan growth, especially you are flagging a pretty strong 60% increase in mortgage lending in the first half, and I'd be interested to hear how you think about the growth outlook for the second half of the year in Hungary in retail lending.

Another question is on the dividends. I was just reading the Hungarian Central Bank statement, which is out today. That seems to be like there's a general ban on dividends until the end of December, but they are also saying that that some banks may be able to pay dividend and one condition they mentioned is that the capital ratio should not drop. Just given that you are already deducted the dividend, the catch-up dividend from your capital, I was wondering whether this statement may imply some room for you to pay the catch-up dividend? I would be interested on your thinking around this.

László Bencsik - Chief Financial and Strategic Officer
In terms of the growth trajectory of Hungarian retail volumes, we expect the trend to continue what we saw in the second quarter. Fundamentally, if you look at penetration ratios, for instance in housing loan, it's still less than 9% of GDP. There is enormous room for growth there. I think it's fair to expect to go back to the pre-COVID growth rates, which we had in '18, '19, and they were in the high teens. So yes, we are quite optimistic in terms of Hungarian growth potential, especially in retail, especially in housing loans.

Comment on the dividend, you very rightly spotted that indeed we have already deducted these potential dividends from the regulatory capital. Therefore, they are not in our capital ratios either. Until the end of September, we are not supposed to make any even conditional internal decisions on dividend payments.

The previous guidance on what we should do until end of September remained. Then they extended it to year-end with some potential exceptions. What I can say is that since we are not supposed to make any decisions, not even conditional on this topic until end of September, we are not making any. We'll come back to this in October. Certainly, we are committed to pay out these dividends, and if not this year, then next year, in the regular course of dividend payment after the general assembly.

What exactly it means for us, be this new communication for the Central Bank related to potential early dividend payments, so without AGM decision, we can pay advance dividend. In normal times, this is an opportunity. Certainly we will all sit down with the regulator somewhere in October, and we will discuss what they mean and what they expect from us. I don't want to attach immense importance to this, whether it's end of September, end of the year or the usual time when dividends are paid. I think we are very transparent about the amount what we intend to pay is deducted from regulatory capital. We talk about this as much as we can do.

Gábor Kemény - Autonomous Research LLP - Research Analyst
And just conditionally, if the NBH were to say, okay, in October, to pay the catch-up dividend, would you call an EGM and go ahead to pay in 4Q? Or would you prefer to wait until next year?

László Bencsik - Chief Financial and Strategic Officer
In fact, advance dividend payments can be decided by the Board of Directors. If it's just advance dividend payment, then this can be done without an EGM technically. But again, this is all theoretical, and I really don't want to make any commitment because we are not supposed to. We haven't discussed it internally because we have specific instructions not to.
Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst

This is Robert Brzoza from PKO BP Securities. I have maybe a more detailed follow-up question on the Hungarian NII. You mentioned that there were 2 one-off items in the first half. I believe that might have been both first and the second quarter, the technical effect related to the loan repayment moratorium and the cash loans repricing for regulatory reasons. My question is could you specify how much did these technical items contribute to the OTP Core NII in the second quarter, and whether that impact would be continued in the following quarters or that will finish now? So that's my first question.

And my second question is on the Stage 2 exposure again in Hungary. If you could elaborate more what has caused the HUF 90 billion plus increase and where it has been due to technical adjustments, which segment this affected most? Why did you decide to make those adjustments after all?

László Bencsik - Chief Financial and Strategic Officer

These 2 items in the NII, the way it works with the moratorium that these one-off losses that we book, we amortize them over the course of the loans. So we book a one-off loss when the moratorium is announced. When this moratorium expires, then we start to amortize this one-off loss, so we increased the NII gradually as if there was interest on the accrued interest. Technically there isn't, therefore we book a one-off loss. Then during the course of the loan, we actually amortize this one-off loss and increase the NII. This is going to stay with us.

The other effect is what happened in the first quarter with the cash loans that those which were sold last year, for last year, they had a lower rate for a temporary period, there was a cap on the amount we could charge on these loans, but that cap ceased to exist from 1st of January. So there was a step increase indeed in NII due to higher APR of these portfolios, and that continues and it is going to stay with us.

So these were 2 step-ups, but we remain on this elevated level for the future.

If we look at the Stage 2 ratio in Hungary, it increased from 16.7% to 17.7%. Mortgages increased 150 basis points, consumer loans increased 50 basis points, and corporate didn’t increase. We monitor this on a monthly basis. Each month, we are on the new assessment, and we look at the relative changes in the creditworthiness of clients. Therefore, there’s some change every month, this is coming from our internal customer rating. We have a behavior rating and if that rating deteriorates then we may change the classification, and improve if it improves, it improves the classification, and that’s a normal process. So there’s always some fluctuation in these ratios. It’s not that we fundamentally changed the methodology, we improved it in a way, because we now for the entire scope of the retail portfolio, of the collectively assessed portfolio, we have relative behavior rating based stage migration rules. For some portfolios, we used to have in the past absolute measures, but now, it’s not there. I don’t see actually any big movement or irregularity here.

Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst

I see. Okay. Generally, I thought in the light of your comments regarding the cost of risk outlook and the potential migration from Stage 2 into Stage 1, and given what we’ve seen in other locations that actually we should have seen at least some slight decrease in Stage 2 exposure in Hungary as well, right? So that’s why I was surprised, while Hungary runs opposite to other countries in a sense, especially given the positive optimistic cost of risk outlook. But I understand this is sort of statistical fluctuation. May I also, once again, on the NII structure, what was then the reason for which on the quarterly basis, if we look into the interest revenue split, then the interest revenue from loans, it increased by 1% only, even though the loan book expanded quite rapidly. Where there is some again statistical variations in the average loan rate or has there been some other effect visible in the second quarter?

László Bencsik - Chief Financial and Strategic Officer

Sorry, in which country?

Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst

On the consolidated basis, it's from the Excel file, it increased from...

László Bencsik - Chief Financial and Strategic Officer

So net interest income, if you look at this presentation, sir, net interest income quarter-on-quarter increased 4%.
Robert Brzoza - Biuro Maklerskie PKO Banku Polskiego, Research Division - Research Analyst
Yes, indeed. But the interest income from loans, it increased from HUF 190.7 billion in the 1Q to HUF 192.7 billion in the 2Q, right? So the increase from the loan book-related interest revenues was much lower than implied by the loan book growth. This is, again, on the consolidated level.

László Bencsik - Chief Financial and Strategic Officer
I have to look into this. There’s potentially also an FX effect. These numbers are in a local currency, in Hungarian currency. I will explain that in detail to you. Okay?

Your first question, so in Hungary, we still have the moratorium. That makes us somewhat more conservative. Also this is what the auditor expects from us. Despite the fact that we believe that our behavioral models which basically describe the risk profile of our customers, primarily not based on their loan payments, but on other factors like how much revenues they have, how much they spend, what they spend on and so on. We believe that these are very strong models, but there’s still some residual uncertainty of what’s going to happen after moratorium is over with those clients who actually participated in the moratorium for more than a year or more than 1.5 years. That introduces some extra conservatism to our methodologies in Hungary. That might be one of the reasons related to your first question.

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

László Bencsik - Chief Financial and Strategic Officer
Thank you. Thank you very much. Thank you for joining us today. Thank you for your very good questions. I wish you all the best. Good health, enjoy the rest of the summer. Please join us our next event, which will be on 5 November, in the usual setup. Good to hear from you, then. Take care. Goodbye. Thank you.

Operator
Thank you for your participation. The Second Quarter 2021 Conference Call is closed now.

Note: unabridged transcript with minor English stylistic corrections.