Strategy and Finance Division

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Transcript

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

Operator

Dear ladies and gentlemen, welcome to the OTP Bank Fourth 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

Thank you. Thank you very much. Good morning or good afternoon depending where you are, and thank you very much for joining us today for OTP's Group 2020 Annual and Last Quarter Interim Report Presentation. We're going to proceed as usual. So there's a presentation I'm going to go through, which is available on the website. So hopefully, you've been able to download it, but you can also follow it on the screen now that we use Zoom. And then after the presentation, we will open the floor for questions and we will be able to answer them.

So let's start with the presentation itself. So if we try to capture the highlights of 2020, it was an extraordinary year. I mean a very, very strange year and a very challenging one. And we believe that we have managed to meet these challenges in a positive way as much as it was possible.

The return on equity, I think at least in European banking comparison it remained quite strong despite the fact that it actually decreased. What we believe very important is that the operating income grew in this difficult environment. Most importantly, the bank remained stable and operationally sound and enabled all times to service our clients despite a difficult COVID environment. Not just there, but we actually accelerated digitalization and innovation, in general, and continued as if nothing happened, our integration efforts, but more about this later. In this environment, we actually managed to grow almost 10%. So the organic FX-adjusted loan growth was 9%. Again, this is a slowdown compared to the previous 3 years that we had, but given the nature of the environment, I think it's a strong number. Then very important that despite precipitous declines in GDPs across the group, in fact, loan quality remained stable and our Stage 3 and 90 days plus due ratios, in fact, improved, and our capital position improved, as well.

Now – if you go deeper into the numbers, then our accounting and adjusted profits dropped – adjusted dropped by 26% and accounting by 37%. Why operating profit actually increased year-on-year 5%. The reason behind lower bottom line numbers was higher risk costs. So we had 4x higher risk costs last year than in '19. I will show you that this risk cost, again, was not due to portfolio delinquencies or increasing nonperforming loans, but basically higher provisions on performing loans. On Stage 1 and Stage 2 portfolios we increased provisioning substantially. So it's not a loss. It's basically a forward-looking conservative reserve what we piled up last year.

Again, return on equity was 13% adjusted. Unadjusted accounting was almost 11%, 10.9%. So I think that's still higher than the cost of capital in this difficult environment. So we are quite happy to present these numbers. Now if we look at the one-offs, then this extraordinary year brought with it an extraordinary new line in the one-offs, a negative one. This is the adjustment, which we had to do because of the moratoriums, which were introduced. This is primarily coming from the Hungarian one. You probably remember that the structure is such that we can accrue unpaid interest, but we cannot have interest on accrued unpaid interest. And therefore, the net present value of these loans actually decreased, and this net present value decrease is what we had to book in 2020. Now in fact, this is going to come back. Accounting-wise it's just a time value problem. Accounting-wise, we're going to have the same nominal income. It was just shifted into the future.

In the last couple of years – one of the key factors was the acquisitions. During the acquisitions, we always have acquisition costs, either positive or negative. In '19, it was actually positive due to the badwill we recognized. But in 2020, all in, it is a HUF 7 billion negative. In fact, the last quarter was actually positive because we released the provision what we made at the end of '19 for the expected sale of our Slovakian bank, which we concluded in November last year. And at the end, there was no need for this additional provision. So the core part of this acquisition effect is actually the cost of the integration projects.

This HUF 28 billion, which was related to the moratorium one-off effect, almost HUF 11 billion came during the fourth quarter because that was the time when the Hungarian structure was extended by another 6 months with the same conditions.

If you look at the P&L lines, there's a lot to tell about this chart. Maybe just a few highlights. So yes, overall, operating profit without one-offs increased 5%. But part of the story is actually the acquisition impact. So not all the acquired banks were fully part of our financial year in '19. Therefore, on year-on-year basis, it's had a positive impact in 2020, they were present full year in the Group plus there was an FX impact as well. So if you take this out, then actually operating profit declined by 6%. So if you look at the composites of this, in terms of the income lines, I think it's a very good news that we actually managed to stabilize the net interest income, despite the fact that the net interest margin declined by 12%. So year-on-year, it went down from 4.12% to 3.61% percent, and that's a 12% decline. But at the same time, loan volumes grew by 9% and deposits grew by 13%. So basically, volume growth counterbalanced the negative impact of NIM decline.

And then there was altogether a 4% negative in fees and commissions, but this line is directly linked to the COVID situation. Especially in Russia, where most of the business is generated from physical POS lending in retail outlets, and then obviously, last year was difficult for physical retail sales.

Therefore, volumes were lower and the fees were lower as well. And in countries like Croatia, Montenegro and Albania, where the countries themselves and their revenues are dependent strongly on tourism, obviously, last year was not a good year. But in this line, I think it's reasonable to expect improvement once the COVID situation is over. Let me go back to the previous level of normal growth, which should be around the level of the nominal to GDP growth in these countries. The good indicators are here, both for net interest income and net fees and commissions. In fact the fourth quarter was positive 2% and 13%, which hopefully shows the future and where we are going.

Costs 2% increase altogether, again, without acquisitions and FX adjusted. I think that's quite reasonable given that actually inflation was relatively strong in these countries. The cost-to-income ratio somewhat increased to 54.1%, but I think it's much more relevant here to look at the cost-to-asset ratio, which actually decreased from 3.31% at 2.9%, so 13% decrease in the ratio, and that is in sync with the NIM decrease. So what we have is a fast-expanding balance sheet – which is negative for the NIM, but also if you measure operational efficiency by the size – it's bad compared to the size of the balance sheet of the bank, than actually, we had a quite good year last year.

And then, obviously, risk costs, which was much higher than last year that was an important factor. If you look at the quarterly distribution of the risk cost, in the third quarter, we had hardly any risk costs and the fourth quarter was a big jump up, and there are various reasons for that; most importantly, that we had the second wave. So when we closed the third quarter in early October, we were not expecting a second wave to come. Then the second wave came in November-December, new lockdowns, and then the Hungarian moratorium was extended and so on and so on.

In general, whenever you look back in the last couple of years, you can also see a year-end increase in risk cost because at year-end, we always try to do everything we can within the constraints of accounting and tax rules to be as conservative as allowed by these regulations, and this is what we did at year-end.

Parallel to the decent numbers, we believe operationally, we did quite well, given the huge challenges. So obviously, we did everything last year, and we continue to do everything to protect our clients and our colleagues from the negative potential effects of the virus. We have spent considerable amount of money. On the group level, there were HUF 7.5 billion additional costs for COVID protection and also for helping where we could in the forms of different donations to health care institutions in various countries across the group.

Now besides this effort, which was extraordinary and that was related to the COVID situation, we continued with our transformation program. We continued the organizational transformation, the agile organization development, primarily in Hungary. We continued with our digital transformation, which will be covered on the coming slide. But remaining on this slide, we actually are adapting to the situation, as you have all done, and we have all done globally. Obviously, within 1 or 2 weeks, we managed to turn the entire headquarter operation basically across the group into home office. So that's a great credit to our IT people, and I think it's a very good test. It was a very good task for our IT operational strength and performance that we managed to do that without having any problem in this regard.

And also, importantly, in this challenging operational environment, we managed to continue; and on time, on budget we finished the planned mergers. Last year we finished the merger in Bulgaria, at the beginning of May, when there was total lockdown. So that was done from home office, cross-border, basically, without any problems really. And then we did Montenegro in December. And Serbia, the second Serbian integration process is still ongoing, and as originally planned, we expect to conclude that in the second quarter this year. We very successfully integrated the new countries to the group as well: Slovenia, Albania and Moldova, these are the new countries who joined during the course of '19. On top of that, we even sold one entity in November: we sold our Slovakian business to KBC, and so we divested that operation.

A few words about digital and digital developments. So primarily focusing on Hungary because if you wanted to show the whole picture across the Group, it'd have been a very long presentation, but just a few numbers here. Well, we are very happy as how SmartBank, our mobile operation with 1.3 million active user has developed. Just to remind you, it's a country with less than 10 million people. So this is the active user number. We have a completely new app, a completely new user interface and the feedback is very good. Digital channels transactions, obviously, increased a lot and the number of digitally active clients did so.

We continued, even accelerated our digital developments in Hungary, but also in other countries. So that's Group-wide basically. The whole COVID situation is tragic and seriously negative, overall, in many aspects, but we could actually find at least one dimension in which it benefits us and the economy and clients, and that's the acceleration of digital adaptation. So we certainly accelerated our digital developments, but also our clients and the clients speeded up their adaption and use much more digital than the non-digital.

Turning back to the numbers and the overall profit of the group, then obviously, we had negative numbers everywhere. And this is primarily due to the increased risk costs. Potentially the only country where risk stayed flat and didn't increase, it was Russia. So in Russia, we were conservative, maybe even too conservative with our risk approach. We cut back on sales, and obviously, demand dropped seriously. So you will see that Russia was the only country where we actually had a serious negative loan growth, volumes contracted, and therefore, revenues contracted. But the risk volume itself did not change. So in Russia, the decline was primarily due to the lower volumes and also margin decline. I mean, total revenue margin declined by 9% from 17.5% to 16%. In all other cases, basically, the negative profit growth is due to the fact that we had higher risk costs.

Turning to total income, next slide, year-on-year 9% growth. Again, that's quite good. Again, this includes the impact of acquisitions. So it's not exactly apples-to-apples, and also the FX changes had an impact. So for most of the countries we actually have 2 numbers, so where either the FX or acquisition or both had an impact. We included 2 numbers, and the right numbers on the right side provide the full picture. So here, the biggest growth, as you can see, was in fact in Romania, and I think this is really in line with our strategy.

And on the previous slide, you saw that Romanian profit was not very strong last year and it declined. But in terms of growth, it was quite strong. And this is volume growth and revenue growth and also cost growth. The reason behind this is very deliberate and conscious because when our second attempt to acquire a bank failed, we decided to start a very aggressive organic growth strategy. We tried to organically grow the bank. And obviously, there's a temporary sacrifice we have to make on the profitability side in order to increase market share and the bank itself. Otherwise, typically, outside Hungary, we had negative numbers adjusted. And in Hungary, we actually had 5% growth, which was driven by the very strong volume dynamics.

If you go to the components of total income, the first item is the net interest income. We try to provide you with some background information on this slide and try to explain what happened. I think this Hungarian 9% growth, again, very good 4% growth in the last quarter, and also you can see Romania here being very strong. The only country where we had strong negative growth was basically Russia, which, as I said, was driven both by lower volumes and also lower margins. In general, the margin compression was an issue. It continued to be an issue last year. Basically, in each and every country, we had lower net interest margin linked to the low interest rate environment and typically very strong growth in deposits. So typically, loan-to-deposit ratios declined. The group level ratio declined to 76%. But also that's typical for each country. The yield on excess liquidity is actually quite low. Also, in a couple of countries, Russia, Ukraine, there were rate cuts. So from a margin point of view, it was a difficult year.

That you can see on the next slide, you see that during the last quarter we had another decline in the net interest margin down to 3.43%, and it's primarily driven by the phenomenal volume growth in deposits, while NII actually increased. So this kind of contradiction in a way that we see declining margin, but at the same time NII growth because of this very strong growth on the deposit side, and we do make extra money on additional deposits, but the margin on additional deposits is obviously less. The margin contribution generated by additional deposits is typically less than the existing average net interest margins because the yield on financial assets is very low.

This year, we believe it's going to be a mix. Just today, Ukraine increased by 50 bps the reference rate. There might be rate hikes in Russia, which has started to see first in the U.S., which later spread globally and pushed the longer end of the yield curve to increase. So maybe there can be some structural change in this one, we will see. But certainly, last year was characterized by gradually decreasing margins quarter-by-quarter, and the last quarter was not an exception, so it happened also during the fourth quarter.

Going to volume dynamics. This slide explains the fourth quarter performing loan volume growth, and it was 3%. I mean, we had an adjustment here: the 0% is including the sale of the Slovakian Bank. So at the beginning of the fourth quarter, we still had the Slovakian Bank, however at the end of the year, it was no longer in our books. So if you adjust with this, then actually, in one quarter, we had 3% loan volume growth across the group, and some countries continued to be very strong: Hungary 4%; Ukraine 8%; Serbia 3%; and we were very happy to see Russia being strong, so in just one quarter growth was 9%. So finally, the trend turned around in the fourth quarter and part of the volumes we lost during the previous 3 quarters we partially recovered.

Now just to remind you, this actually happened during the second wave. So the second wave of the virus hit the CEE countries, not so much Russia and Ukraine but the Central European countries were hit by the second wave, around November and certainly in December. Even in this environment, we had this very strong growth rate, which was actually the fastest-growing quarter out of the 4 quarters last year.

If you look at the entire year, the year-on-year numbers, in terms of performing loan growth, and again, we adjusted with the Slovakian Bank divestiture, then it was 9%, which is quite a solid number given the environment. Obviously, performing loan volume growth was boosted by the different moratoriums. Especially in Hungary and Serbia, this was actually quite substantial because in these 2 countries due to the nature of these moratoriums that they were opt out to clients, i.e. those who did not want to participate, had to request not to be part of the moratoriums. In these 2 countries, we had relatively high levels of participation rates and also not surprisingly high-growth rates as well. But even without these effects, it was quite strong in Bulgaria, Serbia, Romania, 13%; Croatia, despite the difficult environment, 6%. I think this is quite typical what we saw in Croatia that consumer lending declined, but mortgage and corporate lending continued to be strong.

In fact, if you look at the horizontal mortgage line, across the group mortgage loans grew by 10%. And in each country, it's growing and growing. So this is a very peculiar situation that despite the large negative GDP growth in the countries where we operate, mortgage lending continued as if nothing happened, it even accelerated typically, which reinforces our belief that the COVID situation is just temporarily negative external effect to the economy, more natural-disaster-type of situation than a fundamental economic problem. That is also reflected in corporate lending in most of the countries.

If you look at deposits, I mentioned before that the fourth quarter was very strong. And as you can see here, just in one quarter, deposits grew 6%; and like Hungary, 10% just in one quarter. But across the Group, this is quite strong. That shows the continuously high and increasing liquidity in these markets, which is definitely a good thing, and credit to the monetary policies of each of these countries to get through this temporary negative situation, where we are.

If you look at the entire year, then deposit growth was 13%, and across the Group it was the highest in Hungary, certainly, in terms of volume. So if you look at the year-on-year change, in Hungary alone we had HUF 2 trillion increase, and the net deposit to loan gap increased to HUF 4.3 trillion. So this is the amount by which we have more deposits than loans. So this again, increased a lot during last year.

In fact, in each country it was positive, except Russia, where we deliberately decreased the deposit volumes in line with the declining loan volumes. We obviously don't want to pay high cost for funding in the form of deposits if we can't use them for our lending activities, and Russia has self-funded services. This was a deliberate strategic decision to do. The other country where we had negative deposit growth was Montenegro. Montenegro is very unique from a monetary situation point of view because they adopted the euro without being the member of the Eurozone. So it's very specific, and they had less revenues due to the sluggish tourism season during the summer.

Leaving the net interest income part, we have a slide about net fee income. As I said, especially in countries which are dependent on tourism, like Croatia, Montenegro, and Albania, we had a strong decline in fee revenues and also in Russia, where fee revenues are typically generated by the insurance commissions, where we get when we sell insurance products together with consumer loans.

So there was a strong decline in Russia. But these numbers are very much linked to the COVID situation, and we should recover once the COVID situation is not so prevalent. As you can see, through the example of Russia, for instance, the last quarter, fourth quarter, net fee income actually grew 8%. As you saw it on the previous slide, this was the first quarter last year when volume started growing in Russia. I think the good thing is that despite of the COVID situation, actually, fee income growth was solid in Hungary, we have 3% growth, all in, which is actually quite a decent number given the environment we had.

Going to other income, this is obviously, that's the smallest income line, and as usual, there's a lot of noise in it. The Hungarian number dropped in a sizable way due to 2 factors basically: we had less security gains and also we reclassified the purchased, non-performing loans from third parties and the revenues related to them in our work-out unit we had reclassified them into risk costs, and therefore, there is a structural difference as well.

The other line on this slide is related to typically other Hungarian operations and most of it, more than half of this decline, was due to lower revenues of our real estate development unit that we have in Hungary.

Now leaving the revenue side, there's one slide about operational costs, and the trajectory during last year. So again, we have to separate out the impact of the acquisitions and also the FX exchange rate changes as a sizable impact here, so we have to adjust with that as well, and then we get to this year-on-year 2.4% growth.

Obviously, the biggest contributor nominally was Hungary with HUF 14 billion, or 6% growth. But this was primarily related to 3 factors, actually, HUF 15 billion growth was accounted due to 3 factors: one was the increasing depreciation by HUF 8 billion year-on-year. That is just related to the investments that we made during the previous 4 years into IT and into digital development. So it is inevitable, and it's not necessarily negative, it's actually positive. It shows that we are investing heavily into innovation and into developing our digital services, primarily to our clients. So that is coming through the increasing depreciation line. Then we had to pay HUF 3 billion more in supervisory expenses. That's basically related to the growth of our balance sheet and many kind of regulatory fees are linked to the size of the bank, and we were growing fast. So that was related to that. The third item here, HUF 4 billion additionally, that's part of the HUF 7.5 billion, which I mentioned at the beginning: in Hungary fighting the COVID situation and also giving donations to health care institutions was altogether HUF 4 billion extra. So in fact, the year-on-year nominal growth was pretty much explained by these 3 numbers. And for instance, personnel expenses did not grow at all last year. Then we have countries like Serbia, where cost synergies continue to manifest as a result of the first acquisition we made. We had a strong cost growth in Romania. But again, this is in line with the revenue growth and in line with our strategy there that we want to organically grow, and we are investing in developing and growing the bank, the capacities of the bank and the capabilities of the bank to grow organically, and that's reflected in the expenses.

There are some further synergies to be expected from acquisitions. First of all, in Montenegro, we concluded the merger at the end of last year in December. Despite the fact that also last year, we had a 5% decline in acquisition and FX-adjusted operational cost, there's more cost synergy to be expected this year. More importantly, we are going to conclude our second and much bigger merger in Serbia, in the second quarter this year, and we expect substantial further synergies coming from that acquisition starting from the second half of this year and leading into next year.

A few words about Hungary just given that this is our biggest market and especially last year, its contribution to overall profit even increased. First of all, probably you have gotten used to the fact that policy-wise, the Central Bank and the government has been very active during the last 10 years, and that didn't change last year. So I believe they actually were quite fast and reacted very well to the situation and did everything what they could in order to mitigate the negative effects of the COVID situation.

So there's actually a very long list of government measures and also Central Bank measures, which were aimed at bolstering the economy, providing liquidity, providing support, providing subsidies to retail and corporate entities. And I think the fact that eventually the Hungarian GDP decline was much less than originally anticipated was primarily due to these measures. I strongly believe that these measures were needed and were very successful. And the fact is that we ended up with only 5% GDP decline last year. Despite the surging third wave of COVID in Hungary at the moment, we still expect more than 5% GDP growth for this year.

Now if you look at how we performed in this environment related to our retail clients, just the usual metrics we have on this slide. Again, I mentioned that mortgage lending was very strong across the Group. Just looking at Hungary, 15% year-on-year growth in new disbursement. So this is not volume, this is not affected by the moratorium. The new production of mortgage loans increased 15% year-on-year, and we achieved 32% market share. So we managed to further consolidate and improve our market share in mortgages, which is very good. We have been extremely active in distributing the different subsidies and subsidized structures to retail clients, for instance the Family Home Subsidy program. In cash loans we had volume growth of 15%, but again, this is somewhat positively affected by the moratorium. Regarding savings market share, we are around 32%, which is actually the same level where we are in mortgages.

Baby loans that we mentioned, which started back in '19, continued to be very strong last year. You see the quarterly contractual amounts, and then they actually kept quite high. So now end of the year, we had close to HUF 470 billion disbursements from this subsidized retail loan product. And as you can see, our market share in this product remained higher than 40%. So we are overrepresented in this product, and we see that generally. So whenever there's a new policy loan structure, we tend to be the first to be able to provide it to the clients, be it retail or corporate clients, and we always put our full effort and muscle behind this and make our large physical and digital networks available for distributing these products. So that's very obvious from these numbers.

Just as well as the different structures in corporate, so the corporate performance was again quite strong. And the underlying driver was the Central Bank's Funding for Growth program, the new program, which targets to distribute HUF 2.5 trillion funding for Hungarian corporates, primarily medium and small corporates. And as you can see, our micro and small company loans, year-on-year, increased by 55%. So we were very strong in participating in that structure. We have more than 27% market share in this structure.

In fact, our overall market share in corporate lending increased to 16.6%. So this long trend in the last 10 years, trend of increasing market share in corporate lending, continued last year. By now, we are clearly the biggest corporate lender in the country.

So these were the few highlights and glimpses of our performance in Hungary.

Let me turn to the risk part and portfolio quality. There're only a few numbers I'd like to talk about here. It's very clear that the nonperforming loan ratios did not deteriorate. On the opposite, they actually improved. As you can see, the group’s Stage 3 ratio continued to decline year-on-year and reached 5.7%. The 90 days plus due ratio, which is not on this slide, but that as well continued to decline and reached 3.8%, so less than 4% year-end.

So where did this 4-times bigger provisioning and risk costs come from last year? The answer is that it came from increasing the coverage on performing loans. Stage 1 and Stage 2 loans are, by definition, the performing, whereas Stage 3 is the non-performing part. And as you can see, Stage 3 coverage, actually slightly decreased, but Stage 1 and 2 coverage, i.e. provisioning on performing loans increased from 1.6% to 2.4%. And this increase is the reason behind the higher risk cost. So this makes it very clear what happened last year, which has increased substantially the provision coverage on a performing loan volumes, which adds a forward-looking provisioning and a conservative one, I would say.

And to what extent is it conservative? The small comparison on this chart might help you to gauge it. This shows the performing loan coverage, so the Stage 1 and 2. So provisions to Stage 1 and 2 loans divided by Stage 1 and 2 loan volumes, this is the own provisions on performing loans. As you can see, we have 2-times, 3-times more, even 4-times more provisions on performing loans than some other groups who are active in the region.

Now obviously, the picture is still not crystal clear and somewhat obscured by the fact that we had moratoriums across the countries last year. In some countries, it was actually quite substantial and strong, and therefore, had an impact on portfolio qualities, or at least, potentially had an impact on when problems manifest.

First of all, I have to say that I do believe that moratoriums are the right tool to use in this situation. So what we had here, and still have, is not a fundamental economic situation, and it's not a fundamental economic recession. It's a natural disaster, so to say, an external event, which should have a temporary impact. So it makes actually a lot of sense on the policy level to implement moratoriums. During the time when this temporary negative external element manifest, actually you have a moratorium and therefore, don't force clients to default. Once this external force is no longer there, we expect a very safe economic rebound, therefore, a substantial improvement in credit quality and credit growth and support for clients, therefore, they should be able to continue to pay.

Now obviously, the Hungarian policymakers have taken this approach to quite an extreme, in a way that it's a structure which is opt-out. So by default, everyone, all corporate and retail clients, are part of the moratorium unless they asked not to be part. Also it was originally for 9 months, but then it was extended by another 6 months. I think it's quite understandable because it was done when it became clear that the second wave of the COVID disaster arrived to Hungary. Given now that we have actually a third wave, it does make a lot of sense that the moratorium was extended.

In all the other countries, there were moratoriums, typically tiny; but in Ukraine, there wasn't at all. The more surprising, I think positively, that we have such a good credit quality in Ukraine. This is obviously due to our colleagues who have been able to build up a very resilient portfolio in Ukraine.

But other countries implemented moratoriums, which were extended, within the context what was created by the EBA and ECB suggesting that unless the moratorium is longer than 9 months, it did not trigger the forborne status. Therefore, it did not trigger Stage 2 classification. So typically, with the exception of Hungary, all the other countries contained their moratorium extensions below 9 months. So on a client level, despite the fact that moratoriums were extended in other countries, it could not be longer than 9 months.

Therefore, actually, the numbers for the other countries dropped considerably, especially in Serbia. So if you remember, in Serbia, it was very high. In Serbia the affected volume was close to the Hungarian level after the second quarter. But here, it's down to 0. So the early experience is actually quite positive regarding the quality of clients who exited these moratoriums. So year-end, for instance, in Serbia, less than 3% of the clients who exited the moratorium ended up in Stage 3. And in Bulgaria, where we had a much lower volume, it was 2%. So 2% of clients who exited the moratorium ended up in Stage 3. It's only higher in Croatia, close to 9%. But in Croatia, whenever there's an additional extension of the moratorium after the first one, even if it's below 9 months, there, we have to classify it as Stage 3.

So we are quite optimistic regarding the outcome of the Hungarian moratorium by the end of June. I should mention that the level of vaccination at least, compared to other European countries, is quite high, and it's accelerating fast. You probably heard that Hungary is also using Chinese and Russian vaccines on top of the vaccines which are provided by the centralized EU procurement.

So vaccination is accelerating fast, and I believe it's reasonable to expect that by the end of the second quarter, we will reach a very high level of vaccination in Hungary. Therefore, by June, I believe we should be able to open up the economy and be more or less back to normal. Therefore, the second half of this year should be very strong in economic activity. And if we end the moratorium in such environment, then we expect actually very low levels of Stage 3 migration. After exiting the moratorium, we don't expect this to be higher than 5%, it should be rather lower given the experience in other countries so far. Okay. There's caveat here that, obviously, the year-end figures made just the early harbinger of potential problems in other countries, because the time elapsed was not quite enough to manifest all the potential problems yet.

Now fourth quarter risk costs were much higher than the third quarter, but lower than the first quarter, but much higher than the third. And what happened here was that we increased coverages: we increased the performing loans' coverage and increased the Stage 2 ratios. Part of it was related to the Hungarian situation, where, because these loans that are in the moratorium for longer than 9 months, by the regulation, there should be a forborne flag on these loans, and they should be classified as Stage 2. However, the Central Bank gave a guidance that this Stage 2 treatment can be avoided if the revenues of these clients did not decline by more than 15%, or in case of retail clients, if they have at least savings of more than 1 year amount of the loan servicing. In case of corporates, it's basically one-by-one classification and assessment.

This is important because actually the new guidelines by the Central Bank were not applicable to year-end. They are applicable to the end of the first quarter. Now we believe that despite the fact that we use a different methodology, we use our internal rating, we did increase Stage 2, and we believe that we were more or less in sync with these new requirements, at least in terms of Stage 2 volumes.

There's not much which changed in the following slide. This just shows the composition of our loan book in terms of the different sectors, depending on their perceived susceptibility to the crisis, the perceived vulnerability to the COVID situation, so I don't think I should elaborate long on this.

There's one slide about capital ratios, the Common Equity Tier 1 ratio year-end was 15.4%. We listed the different factors here, which had an impact quarter-on-quarter. There were some regulatory changes with some regulatory easing and benefits, especially the treatment of IT software as intangibles. Also, we divested the Slovakian Bank, so that had a small positive impact.

Finally, probably the slide which interests you the most, our assessment of last year and potential outlook for this year. So last year, we talked about 3 numerical ratios. One was the ROE. We expected materially higher than 10% adjusted return on equity. And the fact was 13%, I mean the actual number; and even the accounting number was higher than 10%, it was close to 11%.

The credit risk cost rate, we guided for less than 125 bps, and we ended up with 115 bps. In terms of loan growth, we expected this to be material, 7%, and it ended up at 9%. So we actually delivered on these expectations quite well, I believe.

Now when we watch these things for this year we decided not to give very specific numeric guidance yet. But directionally, we feel quite confident about these statements what we put here. So, in 2021 we expect the return of equity to be better than last year, primarily driven by, which is point number four, lower risk costs. So we expect the risk cost nominally, not just the risk cost rate, but also the nominal risk cost to be less this year than last year. We believe that this is going to be the strongest driver in a potentially higher return on equity number.

Also, most probably the difference between the adjusted and non-adjusted return on equity should be less because we certainly don't expect further extension of the moratorium. Therefore, the last year booked one-off negative due to the moratorium in Hungary and then the extension in moratorium should not manifest this year.

In terms of loan growth, all in all, we expect roughly around the same level of organic growth what we had last year. And in terms of net interest margin, this continues to be a difficult part. Having said that, the very recent development is rather positive on that. I mean, inflation is picking up, and especially in the U.S. the long-term yields increased. We had a rate increase in Ukraine. There should be one in Russia, as well. So hopefully slowly, but at least this extremely low external rate environment is turning around and that should be positive. But it may not be as positive this year to be able to break this long trend of negative development of margins. In line with the net interest margin potential decline, potentially cost-to-asset ratio can improve should this strong volume growth especially in deposits, which is the basic driver behind asset growth, continue.

Overall, the macro expectation what we have is that we expect a very strong growth environment starting in the second half of this year. Short term, it's going to be difficult, it's very clear. CEE countries seem to enter this third wave, especially Hungary, we have a very high increase of COVID cases recently, and therefore, severe lockdowns are implemented starting from next week, but this should be short-term and temporary. So it may have an impact for the next month. But in fact, the recovery can be even stronger afterwards. Certainly with this very effective and high-scale vaccination, especially in Hungary, we see the situation should turn around, quite rapidly and fundamentally, during the next 2, 3 months.

Dividend. The National Bank, in line with EU regulators, extended the dividend payment ban and they gave a guidance, which is interpreted in a way that we are not even allowed to make conditional dividend payment decision. So there will not be decision on the dividend payment at the AGM due to the regulatory requirements.

Nevertheless, we decreased the regulatory capital with a dividend amount of HUF 119 billion, which comes from 2 factors: one is the number, which we have said that we had put aside after '19, and this is the HUF 69.44 billion; and on top of that, based on the formula given by the commission's regulation, we calculated a number for 2020 and that's based on the regulation. These 2 numbers together added up to HUF 119 billion. Now this is actually a level which is in line with the management's thinking. So if there were no dividend payment restrictions by the National Bank, this would be the number which we had suggested for the AGM.

Then technically, just as last year, there will be an opportunity potentially to pay dividend advance, the Board of Directors can make that decision. So we will either pay this HUF 119 billion as an advance payment of dividends this year, or if not, then we'll pay this out next year, plus an additional amount, obviously, after '21. So the intention of the management is to pay out this amount after '19 and '20. It's only the timing, which is not certain at the moment, but sooner or later, it's going to happen.

Then that's an important remark that given our capital position and assuming this amount of dividend to be paid out, we continue our efforts to find value-creating acquisition targets and pursue acquisitions, which drive value for shareholders.

As a final remark and concluding this presentation about the AGM. The emergency situation in Hungary was extended until the 23rd of May. This was done on the 8th of February by the Parliament. This means that exactly the same manner as it happened last year, there cannot be an AGM physically done, unless before the date of the AGM, which was 16th of April, they actually withdrew the emergency situation. Now unfortunately, that is quite unlikely given the current surge in COVID cases in Hungary.

So the most likely course of event is that we are going to conduct these important governance events the same way they were done last year. And this is actually governed by the Government Decree No. 502/2020 (XI.16.). So the details are there, but it's basically the same process what we had last year.

There's a disclaimer, obviously, which you should definitely take into consideration when you draw your conclusions from this presentation.

Finally, we reached a stage where I'd like to open the floor for questions. So please indicate if you want to ask a question and then I'll answer your question, and we do our best to answer them.

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

Operator

(Operator Instructions)

The first question is from Gábor Kemény of Autonomous Research.

Gábor Kemény - Autonomous Research LLP - Research Analyst

Hello, thanks for the presentation. My first question is on loan growth. You mentioned in the report that the Hungarian debt moratorium had an artificial positive impact on growth because of the payment freezes. Would you be able to comment on the magnitude of this? And when you post stable loan growth this year, shall we assume that the pickup in the underlying loan demand will offset the impact of the moratorium in '21?

Secondly, you mentioned that margins are coming down, but the NII is still growing. Can you elaborate a bit about this in Hungary, specifically, how you see the NII growth outlook going into '21?

The final question would be how you think about achieving positive operating jaws this year, meaning that your ability to grow revenues more than costs?

László Bencsik - Chief Financial and Strategic Officer

The answer to the last question is actually quite straightforward. We expect the operating results, so revenues minus costs, to continue to increase as they did last year. So that's definitely the case despite the fact that we expect margin decline.

As far as Hungarian NII concerned, yes, the Hungarian NII should grow. In terms of net interest margin, in Hungary we may actually get to the point when it's not going down so much further compared to, let's say, the last quarter last year. Let me remind you that last year, in Hungary, the reference rate actually increased a lot. We started the year with BUBOR being at 16 basis points and then when the COVID situation hit, it increased rapidly. At some point, it was even higher than 100 basis points even for very short time.

And then we ended up second half of the year to hover around 75 bps. So that in itself had a positive impact on NII. So, just because of this BUBOR increase, we expect the NII in Hungary to be HUF 17 billion higher. But the NIM in itself is more driven by deposit growth actually than anything else. And it's not necessarily actually negative if deposits grow more, and therefore, NIMs go somewhat lower. But yes, definitely, in Hungary, we expect NII increase this year compared to last year, as it did happen in 2020, as well. So last year, we had a growth as well.

In terms of moratorium, I mean, the estimation is that it had roughly 5% impact on volume growth. So without the moratorium, the volume growth in Hungary would have been 5 percentage points less. Now in case of Hungary, the moratorium was extended until the end of the first half of the year. So last year, it was just 9 months and this year its 6 months, but still it is there, and this is substantial. Outside Hungary, the only country where it was material, I mean the impact of the moratorium, was Serbia. In all the other countries, the participation rate was typically between 0% and 10%, and only for a short period of time. So really the bulk of the volume impact on the group loan growth was coming from Hungary. And in case of the Hungarian growth, it contributed roughly 5 percentage points.

So yes, going back to your question, we assume that this macro scenario, which I just tried to depict: we do expect a very active and fast-growing second half. We expect the bounce back, the recovery after the COVID situation, to be very strong. And that should manifest in a substantial increase for consumer loan demand, definitely, and also corporate, especially investment loans and project loans. Not so much change compared to the trajectory of last year in mortgages because, again, mortgages were really strong last year despite the COVID.

So mortgages should continue to do somewhat better, but not substantially better, but we do expect a very different picture, especially in consumer lending starting from the second half of this year.

Gábor Kemény - Autonomous Research LLP - Research Analyst

Very comprehensive. Just a small follow-up, the HUF 17 billion NII tailwind from the higher BUBOR, is this what you expect in '21 relative to 2020? Or have we already seen most of this benefit coming through your NII?

László Bencsik - Chief Financial and Strategic Officer

Good question. So the benefit for last year was 9.5 billion. So 9.5 billion positive NII impact is already part of the base. So the year-on-year difference is not 17 billion, yes, it's just say 7.5 billion or so.

Operator

Next question is from Anna Marshall, Goldman Sachs.

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

Two questions from my side, please. Firstly, to follow up on the loan growth question. So you've described the Hungarian situation in quite a detail. But how do you see generated spread of growth across the group? And not just by countries but also within countries in terms of the lending mix, so do you expect the (inaudible) in Hungary basically is where consumer lending and corporate growth should pick up?

And my second question is on your strategic projects. I've seen some comments on the press regarding M&A. So I just wanted to ask you to elaborate on the comments in terms of the potential new markets as well as the potential M&A in Hungary?

László Bencsik - Chief Financial and Strategic Officer

So for the loan dynamics across the group, maybe it's worth going back to the chart where we had the year-on-year loan growth last year. So Hungary 17% was last year, and again, out of this 17%, roughly 5 percentage point was due to the moratorium. But again, the moratorium continues into this year. So there will be an uplift of less than 5%, maybe 3, 4 percentage points. And then all the subsidized structures in the Central Bank programs continue into this year. Actually, there's a new one, it's the new subsidized refurbishment loan, which is just starting. And there's another one, which is new, so there are new structures coming on a policy front, which should boost lending.

But in Hungary, consumer loans should be even stronger than this 15% growth we had last year. Bulgaria was not very strong last year except mortgages. I don't think we will have a much higher growth rate in mortgages than last year, but certainly, consumer loan growth should restart in Bulgaria in second half of this year, definitely, and also corporate as well.

Likewise, Croatia. I mean, in Croatia, consumer loan growth was negative, but it should pick up. I don't expect higher than 15% corporate, but certainly, consumer lending should pick up.

Serbia was very strong last year with a sizable impact from the moratorium. We estimate it to be somewhat less, maybe 4 or 4.5 percentage points potential uplift in Serbia coming from a moratorium last year. And there, it won't be there. So potentially, Serbia will be somewhat less in terms of growth this year than last year.

Slovenia should pick up, especially on the corporate side. And also consumer, we had 9-10% negative consumer loan growth last year. This should turn into positive this year.

Romania should continue to grow. There, the moratorium impact was quite small.

Ukraine was strong last year. There's an interesting development in potential restarting mortgage lending in local currency. So that has something to be watched in Ukraine as a new phenomenon. In the second half, there can be higher consumer loan growth.

Certainly, Russia should be very different. In Russia it is a short-term consumer loan business focusing on physical distribution channels. Actually, consumer loan volumes in Russia grew last year, but we contracted, due to the peculiar nature of our point of sales dominant presence in Russia. But just to remind you, the last quarter, in fourth quarter, we grew 9%. And in Russia, 6% was the consumer loan growth. So I very much hope that we are going to have double-digit growth in Russia, all in, this year as supposed to double-digit decline last year.

Montenegro, again, second half of the year should be much stronger, assuming that the tourist season will already be relatively strong.

Albania and especially Moldova were extremely strong last year. It's more a kind of competitive situation in Moldova because the other banks had their very specific big difficulties, and we were only one of the few banks who continued lending, and therefore, our market share increased considerably. So that's more or less a picture across the board.

M&A, yes, the Chairman made some comments. He said in the morning on the press conference that we continue to pursue acquisitions. We continue to try to find ways to do value-creating acquisitions for our shareholders.

There are 3 countries what we are looking at the moment seriously. So when we actually have processes ongoing, and out of these 3, one is in the current portfolio, but he did not specify what the other 2 were, so I won't do that either. I'm sure you were going to ask, but I'm not going to tell.

So we have some very promising and interesting prospects, I think, and so we are excited about that.

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

And then just a quick follow-up on that last question. So is this something that could potentially be visible this year? Or it's more of a story for next year?

László Bencsik - Chief Financial and Strategic Officer

Yes. Out of the 3, I mean, 2 actually can manifest, I think, quite possibly this year.

Operator

The next question is from Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

Congratulations on your very good results. I've got 2 questions over here. The first question regarding the moratorium, you described the impact on loan growth to be about 5%. Can we also understand about how such moratorium affect your computation of NIM? How are the deferred interest payment considered when you come up with your NIM figures? So that's my first question.

The second question is that we know that in the fourth quarter, there's a certain risk cost and almost all of that came from subsidiaries. Can we understand more about how the risk cost being set when it comes to the different geographies? I mean, along the same line, we observed that the coverage ratios, in particular, the Stage 2 coverage ratio actually has dramatically increased across most geographies, except for OTP Core in Hungary. So that is more or less stable. But everywhere else, we see that the coverage ratio actually has gone up meaningfully. May I know is this due to a regulatory guideline? Or is this due to your internal model that motivates you to be doing this?

László Bencsik - Chief Financial and Strategic Officer

Okay. The impact of the moratorium on NIMs. There is, in fact, no NII impact, you don't see an impact because it was in the one-offs. So the adjustment, which was minus HUF 28 billion, that's where we recognize the negative impact on the NIM, basically.
But it's not a loss. It's in a way, a kind of provision, which we're going to reduce when we present the NII numbers in Hungary in the future. So, despite the fact that it should have a negative impact on NIM because there's no interest on the capitalized accrued interest, right? Which technically should lead to a negative NIM impact. But this is actually counterbalanced or corrected by the one-off loss we booked. So this forward-looking NIM difference and NII difference was realized already last year as a one-off item. I don't know whether it's clear because it's quite technical.

Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

I see. Can I also ask that because the moratorium has increased the loan book somewhat than it otherwise would have been, would that also have an impact of artificially lowering the NIM?

László Bencsik - Chief Financial and Strategic Officer

Again, basically, no. It won't go over the NIM because we are going to book higher revenues, interest revenues, than what we recognize. And we will compensate that with this negative amount what we booked last year. So this difference is in the future expected net interest income, the negative difference due to the NIM decline due to the fact that there's no interest on the accrued interest payments, is compensated in the NII, and therefore, in the NIM.

Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

Understood.

László Bencsik - Chief Financial and Strategic Officer

Okay. So, the coverages, right? Indeed, in Hungary, we increased the Stage 2 ratio, and the Stage 2 coverage decreased. But they went in line because it's actually done on an individual account basis. So it's a very granular model what we have. And the new volumes, which we classified as Stage 2, were less risky than the previously classified loans as Stage 2, and therefore, required less provision coverage. Therefore, all in all, the coverage on Stage 2 did not increase.

In fact, it slightly declined. Now in Hungary, we made this quite large reclassification, partially due to the extension of the moratorium. And anticipating the fact that, if there were no other guidelines from the Central Bank, starting from 1st of January, we should classify the entire moratorium portfolio in Hungary as forborne, Stage 2 or Stage 3, but at least Stage 2 because these loans are more than 9 months in the moratorium."

Now the Central Bank came out with a new guidance that it doesn't have to happen for all loans, but only for those retail loans, where the income to the client declined by more than 15% or where there's not enough saving for client to cover at least 1 year loan servicing costs. And we used our internal models, where we tried to calibrate it in a way to more or less fulfill the criteria, at least on a level of the Stage 2 volumes, overall, set by the Central Bank. So therefore, we don't expect a major movement in the Stage 2 ratio at the end of the first quarter, where pro forma these new guidelines from the Central Bank have to be implemented.

Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

Yes, that's clear. But can you also provide some color on why other subsidiaries, the foreign entities, why is there a sudden increase in risk costs in the fourth quarter? And at the same time, we observed that their coverage ratios are meaningfully higher compared to the same time last year?

László Bencsik - Chief Financial and Strategic Officer

We had a big jump in Stage 2 ratios in Slovenia and in Albania. Now this is due to the fact that in these 2 countries, we implemented the group standards in the fourth quarter. These 2 countries we acquired back in '19. And actually, when we do an acquisition, we have to net out Stage 2 and Stage 1 provisions. So, only Stage 3 provisions can stay. And then after a year, we have to write them back, that's the accounting rule for acquisitions. Because we have to recognize these assets at their fair value.

And Stage 1 and 2 provisions are meaningless in terms of fair value, right? Because this is accounting-wise not part of fair value. Therefore, there was the big increase in the fourth quarter in Slovenia because we acquired this bank in the fourth quarter in '19. And we kind of rolled back these provisions there and implemented in full scale the group methodology. The same happened in Albania. We implemented the full scale group methodology in Albania at year-end.

Now coverage ratios, yes, they are different. So, there are some outliers like Russia. Stage 2 coverage in Russia is 43%. That's clearly an outlier. Because in Russia, the nature of the portfolio is short-term granular consumer loans. And there's practically no moratorium there and this is very much based on a migration matrixes. So, we pretty well understand and this is business as usual, more or less. So, in Russia, the risk cost rate did not increase so much. So what we have was a coverage increase at Stage 2. But in itself, this is just kind of business as usual.

And then Ukraine was higher than the others, but this is something you would expect. And then the rest is basically moving between 6% and 9%, 10%. And they are very specific model level reasons for each of them and somehow go in line with the level of the Stage 2 ratio.

So typically, when in a country, we have a higher Stage 2 ratio, then the coverage on Stage 2 is less because we classify more into Stage 2, but this Stage 2 is actually quite diverse portfolio and different loans, individual loans, can have very different levels of provisions in Stage 2 depending on their individual internal rating. So when there's a rating category deterioration, we put those loans into Stage 2, but that level of deterioration can be quite different. And typically, when we have a larger Stage 2 ratio, let's say, in Croatia, and in Croatia the ratio is 14.7%, and the coverage is only 5.7%. In Serbia, the Stage 2 ratio, 8.6%, coverage is higher, it's 8.5%. So it means that in Croatia, more loans deteriorated, but the deterioration level was not as strong as the previous volumes. And therefore the coverage declined in Croatia.

So this is actually very complicated. These are enormously big models based on individual loans. So first of all, the classification is based on individual loans. And based on individual client behavior, typically, these are behavioral client scores, which change the Stage 1 to Stage 2. And then depending on their behavior, there's a different level of PD increase, or expected loss increase and this is different by product and country. And then even the overall coverage ratios can change depending on the expectation of the economic environment development in that given country. So it's a bit complex.

So to be honest, there's not much historical experience to this Stage 2. How it behaves? What it means? It can mean very different thing for each bank. Therefore, actually, if we can go to that slide, maybe where we have the Stage 1 and 2 coverages. So we concluded that most probably the best number to look at is Stage 1 and 2 coverage. So we have performing loans and non-performing loans. Nonperforming loan definition is quite clear, right, the Stage 3. And the definition of Stage 3 is actually quite similar to the previous non-performing loan definition. So that's okay. And coverage on Stage 3 is reasonably stable. And it's easy to benchmark different banks with this level. And that's what you see on this slide.

Yes, I mean, numbers range between 47 to 65%. But when we go to Stage 2 individual coverage and Stage 2 ratios themselves, they're very different. If you look at different banks, for the sake of space, we did not include the slide today, but in fact, we have a slide which compares different banks, Stage 2 ratios and coverages, and it's a very different picture.

The only thing which is similar is that typically the Stage 2 ratios increased 2x, 3x last year for most of the banks, except KBC. I don't know what KBC does because for them it's actually flat. But typically, Erste, Raiffeisen and UniCredit, Intesa, you see 2x or 3x - typically 2x higher Stage 2 ratios at the end of 2020 compared to 2019.

But Stage 2 coverages are very different and Stage 1 coverages are very different. So therefore, we actually find it quite useful to combine the Stage 1 and 2 portfolio. This is performing by definition. And look at the level of provisioning of that portfolio! This is what you see on that slide compared to some other banks who are active in the region. I think these are the good numbers if you want to start from a high level to try to understand the level of provisioning and conservatism of different banks, but this is a fairly new metrics. And actually, last year was extremely challenging, I think, for all banks, how to use a model because, frankly speaking, all these forward-looking expected loss models, economic models used past data, and we did not have a natural disaster during the last 20 years, as long as typically these data expand.

So we had economic recessions, and typically, these models were built on those environment, and all of a sudden, we were hit by a very different external event, which created quite unexpected results, namely that we had huge magnitude of negative GDP growth across countries. But the portfolio quality, at least measured in terms of nonperforming ratios remained quite stable, which I'm sure none of the original models had these outcomes based on the previous 10, 15 years data, which they were built on.

So I don't know to which extent I answered your question. So, the big changes I can tell you why they happened and how, but it's just Stage 2 ratios and Stage 2 coverages, that's actually very complicated. And I'm sure it's very complicated for all banks. First of all, the classification of Stage 2 and also the provision levels, the expected losses what we assigned to them.

Kian Huat Lim - CSAM Asset Management Pte. Ltd - Director of Research

Yes. Sure. I mean, it's very detailed, and clearly, it's quite complicated. But if I may just add on just a bit, which is, why are we seeing that risk costs for the fourth quarter concentrated in the subsidiaries, but basically nothing for Hungary?

László Bencsik - Chief Financial and Strategic Officer

Because we said that we created more and longer in the previous quarters. So we just reallocated the provisions. I mean, in Hungary, that's what primarily happened. We decreased Stage 1 coverage and we decreased Stage 2 coverage and we increased stage 2 ratio. So in a way, in Hungary, I mean, to be frank with you, we have the most sophisticated models in Hungary. That's where we have the longest time series, that's where we have the most reliable data, most granular data. So we can do the best quality modelling on the Hungarian portfolio.

So we did it already at the end of the second quarter. And we just allocated it differently at the end of the year, more or less.

Operator

The next question is from Andrzej Nowaczek, HSBC.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Great. My question is on the new house renovation subsidies. Can you try to quantify what the impact could be on volumes and profits this year and next? And also in this context, is the demand for other subsidized loans, like baby loans, likely to slow?

So do you see this new house renovation scheme as a tool which can just maintain the momentum? Or will it have an incremental positive effect on your loan growth and profits in Hungary?

László Bencsik - Chief Financial and Strategic Officer

We expect around HUF 50-60 billion additional volume from this refurbishment plan. And as you can see from the baby loan, it's quite persistent. There's some decline, but it's not a big one. So new production will be somewhat less this year, maybe HUF 20 billion, HUF 30 billion less than last year in baby loans.

Andrzej Nowaczek - HSBC, Research Division - Analyst

Okay. So that extra, I think at one point, you mentioned 3% to 4% extra growth in Hungary. That is not necessary to come from those new products? It's just the economic growth momentum improving, right?

László Bencsik - Chief Financial and Strategic Officer

Yes. I mean the subsidized structures continue this year. So, year-on-year, they may not make a big difference, the baby loans may actually decline more than just HUF 20-30 billion. But certainly, this new refurbishment loan should kind of counterbalance the decline in the new baby loan volumes. So therefore, from the subsidized products point of view, there shouldn't be a major difference between this year and last year. But yes, I mean, fundamentally, we expect bigger economic activity, with more consumption in the second half of next year and new investments starting, too.

Operator

The next question is from an attendee joined via phone.

Robert Brzoza - Dom Maklerski PKO Bank Polski S.A. – Security Analyst

This is PKO Securities. I have a few quick questions. I've noticed that in a number of locations, be it Bulgaria or Serbia, you have modified the parameters of your risk model. And I'm wondering if there are, possibly in the future, maybe next year, any macroeconomic top-down scenario under which you would potentially reverse those, as I understand, the more conservative parameters, which you put into the model? So that's the first question.

Second, when I'm comparing the banking sector in Hungary, the new volumes, the new production on mortgages reported by the Duna House, volumes of transactions on the housing market, I'm seeing actually that volumes of transactions are rising over the recent couple of months, whereas the volume of new loan production is actually going down on an annual basis. And I'm wondering whether you are experiencing this as well? And what could be the potential explanation for that and the outlook in this regard?

And my third question would be, if you could repeat the default rate, the approximations that you have given during your presentation for the exposures, which came out of moratorium in few of the countries where you operate?

László Bencsik - Chief Financial and Strategic Officer

So starting from backward, what I said was it in Bulgaria, the volumes which ramped to Stage 3 after the moratorium, it were roughly 2% of the moratorium volumes. In Serbia it was around 3%. And then we definitely expect less than 5% in Hungary also in terms of the moratorium volumes.

Reverse in models, there's a potential for strong provision reversals, starting from the second half of this year, in our view. In order for this to happen, there has to be a strong economic rebound. And our view is that this is actually going to happen and we expect a fast-growing strong environment starting from the second half of this year. And if that comes true, then it's going to have 2 implications.

One, there will be very small increase in Stage 3 ratio. So out of the current Stage 2, actually only a very small portion will migrate to Stage 3. And the other one is that the increased level of provisions, which we've created for performing loans, Stage 1 and 2, this 2.4%, there will not be any reason to keep them at that level.

So at the end of '19, this number was 1.6%. So, theoretically, if all goes well, and we are turning into a very dynamic economic growth period also characterized by increasing inflation environment and inflation is actually good for credit quality, typically, because income of clients increases, and they learn the real value of their loans inflate away.

So yes, it can happen that we will have sizable provisions across the banking sector, I suppose, in Europe and globally as well, if things go according to plan. And the COVID negative economic impacts seem to be there.

In terms of monthly new production of mortgage housing loans in Hungary, in fact, last year, the peak was in September. And in fact, November and December was slightly lower, actually quite materially lower new production in November and December compared to, let's say, August, September and October.

But just to remind you that actually lockdown started from November, the second week of November. So there's a curfew and everything. So this might have a negative impact. Recent data is actually very strong. So February was quite strong in terms of transactions on the retail real estate market. I don't know whether this answers your question.

Operator

The next question is from attendee joined phone. I opened the line. (Operator Instructions)

Olga Veselova - BofA Securities, Research Division - Equity Banking Analyst

This is Olga Veselova from Bank of America. I have 3 remaining questions. One is about dividends. I appreciate the explanation about the booked dividend for 2020, which you will pay once you are allowed to pay. Given that before COVID, you were following the progressive dividend strategy, do you think that this new booked amount can be the basis for future payments or we should rather view this booked payment as exceptional given that it's for a couple of years? So do you think this is a new basis or a spike and then we will turn to normality?

My second question is about your sensitivity to higher rates. Could you please remind us your sensitivity to the yield curve for BUBOR currently in Hungary?

And also, my third question is about cost. You mentioned that you are increasing spending on digital, which is great. In total, could you help us understand how much percentage point this adds to your annual growth cost? And I'm more interested, of course, in 2021 and going forward rather than about 2020.

László Bencsik - Chief Financial and Strategic Officer

So the dividend. This HUF 119 billion is for 2 years, this is for '19 and '20. So if you round it out, then HUF 70 billion is after '19 and HUF 50 billion is after '20. And we had a decline in profit, in after-tax profit of 37% between '19 and '20.

So in a way, it's a spike, because it covers 2 years. If you say that HUF 70 billion is attributable to the results in '19, then HUF 50 billion is attributable to the result of '20. First of all the decline is proportional to the decline in accounting and adjusted profit.

So, we haven't formulated any view on what we would pay or suggest to pay after '21. But given the guidance that the ROE should improve, both adjusted and the unadjusted, and we continue to accumulate equity, therefore, it suggests that we should have higher after-tax profit this year than last year. So it makes sense that we should pay more after this year than the HUF 50 billion we were paying for last year.

How much more? I don't know. But in a way, it's not a spike. It's just 2 years together paid in one amount. And the second year was lower profit than the first year. So the attributable dividend payment is less. So that's the logic.

Sensitivity to BUBOR: for an additional 10 basis points, we expect HUF 1.7 billion NII sensitivity on an annual basis. If from the current 75 basis points BUBOR there's 10 basis point increase, then this should translate into HUF 1.7 billion more NII in Hungary.

I can also give you the euro rate sensitivity: should the euro rate increase by 10 basis points, the annual impact would be HUF 2.4-2.5 billion. So, we actually have a higher sensitivity to euro rate at group level, obviously, then to the BUBOR.

Having said that, I think there's more chance for the BUBOR to go up somewhat than the euro rate, but who knows.

And your third question was related to digital, I think I mentioned it during the presentation. In fact, the investments in digital can be captured in 2 ways: one is the increased headcount and personnel expenses, but that happened back in '16, '17 and '18. So from '19 to '20, we did not really increase further the number of IT people. Therefore, if you look at our personnel expenses in Hungary, they did not grow. That had already happened, that's already part of the base, so to say. And the other way that it manifests is the increase in depreciation because the actual investment, so the CapEx investment, you don't see in our numbers. That comes in subsequent years through increasing depreciation. As I said last year, in Hungary, there was an HUF 8 billion increase in depreciation. And this represented actually much more than 50% of the cost increase in Hungary last year. And there will be further increase in depreciation this year and next year. So basically, these digital development in terms of higher cost base manifest in higher depreciation, and that's going to continue to increase next year and the following year, as well.

Olga Veselova - BofA Securities, Research Division - Equity Banking Analyst

That's perfect, very clear answers. On the last one, can I clarify, this more intense spending on the digital is in Hungary only? Or in other countries, (inaudible) spend more now than before?

László Bencsik - Chief Financial and Strategic Officer

In the first stage, it has mostly happened in Hungary because we are developing group level solutions, which we first implement in Hungary and then plan to roll out to subsidiaries. And there's a very strong internal development content, so there's less license implication here.

The second stage when we roll this out into the subsidiaries, there will be an impact on cost. So, cost will be somewhat higher, but not as much as in the first phase. In the first phase, we started the development in Hungary. We are developing the new applications, which we are going to implement then in the subsidiaries, which will involve some higher costs, and we just started that. So, this phase actually started last year, and it does involve somewhat higher cost, but not as much higher as the first phase.

Operator

The next question is from Alan Webborn form Societe Generale.

Alan Webborn - Societe Generale Cross Asset Research - Equity Analyst

Hi, just 2 more questions, if I may. Firstly, on Russia, clearly, the margin has been coming down and came down again in 4Q. Rates are probably not going to go up very much, if at all, in 2021. Maybe a little bit, but not much. Do you think rates or the margin has bottomed out in Russia? Or do you think it will go down further? And is it simply related to the trend in interest rates? Or is there something structural going on?

And maybe a slightly broader question on Russia. You've talked a lot today about the benefits of digitalization and looking for something positive to say about the crisis that we've all been going through, but it does make point-of-sale look rather superfluous and yesterday's format. I mean, do you think that the Russian business, as it stands, with this focus on point-of-sale really is fit-for-purpose in an increasingly digitalized world?

I'd be interested in your view on that and whether the Russian business needs to be adjusted further? And then the other point was – I mean, the message I think you're giving to us today is that, yes, the next couple of months could be a little bit uncertain because we don't know about COVID and closed economies and so on. But you seem quite convinced of a big macroeconomic pickup in the second half, really without any scarring. And therefore, you seem to be quite prepared to open your loan books, grow, and you're not too worried about asset quality when that happens. Are there, within your sphere, within your geographies, any areas that you're more concerned about scarring and the longer-term effects of the crisis than others?

László Bencsik - Chief Financial and Strategic Officer

Russia NIM. Well, yes, I agree. We expect some increase in the rate environment, but not too much. So maybe 25, 50 basis points increase. Part of the NIM decrease last year was indeed structural. So, if you can go to this year-on-year volume change slide again, page 13, you can see that there was an overall decline of 11%, but consumer declined much more than corporate. Obviously, there's a huge margin difference between consumer and corporate. So, the margin is excessively more on consumer loans than on corporate loans.

Part of this margin decrease what we experienced last year was indeed structural. Hopefully, this growth can turn around this year, and we see, again, growing consumer loan volumes, higher rates than corporate, and that can be positive for margins.

In terms of our difficulties in Russia, indeed, it is structural. So, to be very honest, when we acquired the bank in 2006, and the bank had a very strong business line in physical point of sales loans, at that time we were anticipating that maybe for another 5-7 years, this can be a good business, but then may fade away, but 15 years after it's still there.

Yes, it was hit more than the rest of the market, but still, you are right that this is not the product of the future. Physical POS is not the product of the future, not just in Russia, but nowhere.

I mean if you look at China it is a good example in that respect because if you look at the last 3, 4 years, what happened in China and how successful just 5 years ago Home Credit was with its huge physical POS franchise in China and how much difficulty they faced last year when the market migrated substantially into digital and primarily just mobile-based applications.

So yes, the future is more and more digital. And this is going to happen in Russia as well. And indeed, the acceleration in digital actually structurally makes the situation more difficult for us in Russia.

This is not something new. We have been aware of this since we brought the bank that at some point, this is not going to be any more such an attractive market or at least the growth potential of that segment might not be so big.

In fact, 2 years ago we launched a number of new strategic initiatives. And we continue to try to diversify and find out new ways of revenue growth.

For instance, we apparently quite successfully started to grow in car lending last year. This is something we are developing. Obviously, we are trying very hard to catch up with our competitors in terms of our digital services. And again, Russia is not as advanced in terms of digital as China, but I think it considerably more advanced than actually Europe.

So if you look at Tinkoff and Sberbank and then what they do and how they do it, it's really a quite sophisticated environment, and we have to be very competitive in digital as well. And then we have various other initiatives. It's a bouquet of like 10 different initiatives that we are working on in order to create the future growth platform for our Russian bank.

Regarding the macro expectation I mean, for us, it seems rational. Once this COVID is over - okay, the vaccination is somewhat slower in Europe than it should be. But if you look at the U.K or Israel, and if you look at Hungary, in 1 month, though there has been an enormous growth in the percentage of vaccinated people.

This weekend, they want to vaccinate 400,000 people just in 2 days, which is like 4% of the population. So this can be actually quite fast, if done well. And once we reach 60%, 70% of vaccination, then the systemic lockdowns should not be any more necessary. Then I'm sure during summer, if people will be able to travel, they will. I mean, everyone. And there'll be a big surge in tourism, a big surge in travel. Everyone will start to buy new clothes and things like that.

I think the only potential threat to the scenario is if there's a new version of the virus, for which the currently developed vaccines are not effective. I think then we have a big problem. Honestly, I'm not a scientist, so I don't know the probability of that. If that happens, the question is how fast a new vaccine can be developed. But if that happens, then it can be a serious problem.

If we have another summer with lockdowns and so on, and then ultimately, at some point, it can turn into kind of negative expectations of the economic players, and financial sector problems, creating a classic economic recessionary situation.

So there is a possibility of a negative scenario, but honestly, I'm certain that this is not the probable case because at the moment, as far as I know, we don't have a version of the virus, which cannot be affected by the current vaccinations.

Therefore, the current vaccination should work. There's acceleration in vaccination and by the third quarter, by June, July, at least in Hungary, and I hope in most of the EU countries, we will have a very high level of vaccinations.

This is going to be more or less over in terms of real economic impact, real impact on how we live. I mean, the virus will be with us, and we may have to be vaccinated every year or something like that. I don't know. But the negative economic impact should not be there. People will want to consume, will want to travel, will want to go out. And therefore, there will be a huge surge in demand. Inflation will go up. Investments will start but there will be bottlenecks, so people will invest and projects will start.

So there will be a surge in economic activity unless there's a new version of the virus, which is resistant to the vaccines. I think it's pretty much inevitable.

Then the big question is how long it's going to last. It's 1 year, 2 years, 3 years, 5 years, whatever. And whether it will be overheated and how the monetary and fiscal policies will react and so on and so on. But that's another story. So honestly, I don't know. I can't answer it.

I mean, this is something we will talk about a year from now. If we have 6 months very strong economic rebound in the second half of this year, then a year from now, we will talk about overheating and so and so on and the potential risk of that and what policy responses will be there.

But I don't know the answer.

Operator

The next question is from Simon Nellis, Citigroup.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Just a quick question for me. Can you remind us of the outlook for acquisition effects this year? And I guess in a related question, can you elaborate on the synergies that you're still extracting from M&A? I mean, can we see another year of basically flat costs in Bulgaria because of the acquisition you made, I guess, now a year ago?

And in Serbia, should we expect some material cost synergies to come through?

László Bencsik - Chief Financial and Strategic Officer

In Bulgaria, in terms of cost synergies, there's still some 50, 70 people we plan to optimize, so to say. And we actually started a very ambitious new strategic transformation program. When we acquire a new bank and we have a merger, we have a saying that ‘merge first, improve later’. So when we have a merger, it typically takes 1.5 years. And for that 1.5 years, there's not much development.

Whenever we do a merger, we always have in mind that when the merger ends then we start an improvement project. And this is quite large-scale work what we do now in Bulgaria, a pretty comprehensive strategic transformation program.

You probably noticed that we have a new CEO there. So, our former CEO, Mrs. Marinova, who had retired after more than 40 years very successful career in the bank. And we have now Mr. Hák-Kovács as the CEO. He used to be the CEO for the last I think, 6, 8 years in Ukraine. The very good performance of the Ukrainian bank, which we saw in the previous couple of years, was made possible by him and the team, which he led in Ukraine, and now he moved to Bulgaria last autumn. So we had quite a comprehensive strategic transformation program.

They will have strong results, I believe, especially in terms of growth, market share capture and service development and client service development and so on and so on. In terms of the cost itself, I hope that we are not going to increase the cost in Bulgaria. In a good scenario, we can have some small further decrease in an inflationary environment. So yes, there's some more savings to expect in Bulgaria.

In terms of Serbia, we pretty much extracted the potential savings from the first acquisition, and it was quite substantial. There are 2 ways to look at it. One is as a percentage of the combined entity or the percentage of the smaller entities. So the cost savings are taking into consideration inflation. As percentage of the smaller entity in Serbia, as the result of the first acquisition, it was actually 70%. So we took out 70% of the smaller bank's cost base in Serbia after the first acquisition. And that was already in the numbers last year. But then we have another merger, which we should finish in the second quarter. And this is a bigger bank than what was acquired in the first phase. So we should see the impact next year, and also this year. This year there might be low single-digit decline in Serbian costs. And next year, there should be actually a double-digit decline in costs.

And we also expect cost synergies to be realized in Montenegro, which is small from group perspective, but in terms of percentage there, it can be actually quite visible.

Simon Nellis - Citigroup Inc. Exchange Research - Research Analyst

Okay. And just one last question on M&A. Maybe I missed this, but the 3 targets that you're looking at, are they all in existing markets? Or are you looking at new markets?

László Bencsik - Chief Financial and Strategic Officer

As the Chairman said in the morning, during the press conference, out of the 3 countries, 1 is in our current markets, and the 2 are in new markets.

Operator

There is a question from an attendee joined via phone. (Operator Instructions)

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

This is Máté Nemes from UBS. I have 2 quick follow-up questions, please.

One is on provisioning approach for the first half of '21. So, after the significant migration to Stage 2 that we saw last year and the increase on Stage 2 coverage or as a combined Stage 1 - Stage 2 coverage, shall we now expect really individual assessments and then case-by-case provisioning rather than the further management overlays despite some of the additional lockdown measures that were put in place? That's the first question.

And the second one is a follow-up on acquisitions. Can you just share with us how do you think about excess capital available for acquisitions now? In the past, you flagged the 12% to 18% CET1 range that you feel comfortable the bank can move in. Is the 12% lower band relevant number here?

László Bencsik - Chief Financial and Strategic Officer

Overlays. We did not actually apply many overlays at the end of last year. We applied some floors. In some countries, we applied floors, PD floors based on expert judgment. That we did. But the models are everywhere kind of granular based and bottom-up built up.

We don't have this kind of big portfolio level overlays, which are not substantiated with detailed individual loan level models. The only kind of overlay type, it's not an overlay, what you could call as an overlay is that in some countries we introduced floors, in order to reflect a kind of conservative approach based on expert judgment, and it was well documented and discussed in detail with the auditor – actually with 2 auditors because now, by the way, we are rotating: Deloitte who has been our auditor for a very long time has to rotate (inaudible).

We have talked about 2 things today. One is that there's a guidance or expectation that risk costs this year should be lower than last year. And how much lower? If this economic scenario, what I just described, manifests and the second half of this year is really that positive, then it can be substantially lower. The other thing I said was the extension of the moratorium in Hungary by another 6 months, and in the case of the loans in the moratorium, according to European-level guidance that with shorter than 9 months moratorium participation, there's no forborne trigger. And therefore, there's no automatic Stage 2 migration.

But the Hungarian moratorium extends over 9 months. And therefore, it could actually trigger automatically a Stage 2 migration, but it does not because the Hungarian Central Bank came up with a guidance where they specified under which circumstances retail and corporate loans are waived to be classified as Stage 2 despite the fact that they continue to participate in the moratorium.

What I said was that more or less what we did year-end in Hungary, in anticipation of these requirements by the Central Bank, are numerically on a portfolio level, more or less in line with what should happen at the end of the first quarter according to the National Bank's expectation.

I mean in plain language, it means that just because of this, there shouldn't be further increase in Stage 2 ratios as far as we understand today.

Well, unless there's a material deterioration in the expectations regarding the environment or something unexpectedly negative to happen, we don't feel further need to exercise further conservatism in creating more provisions.

Sorry, you had another question regarding acquisitions, but I didn't quite fully...

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

Yes. That definitely helps. The other question was on excess capital that...

László Bencsik - Chief Financial and Strategic Officer

Yes, yes, I remember. Okay. So yes, we have not changed that 12% to 18% kind of guidance. So technically, we can go down to 12%. Actually, there's even more room because now temporarily, the capital requirements were reduced as you can see on this chart, the Other Systemically Important buffer, which used to be 2%, this was reduced to 0% for last year and this year. Next year it's going to be 50 basis points. And in 2 years, it's going to be 100 basis points.

So today, we don't have alternative Tier 1 capital elements. So for us, the Common Equity Tier 1 requirement is really the Tier 1 requirement. So therefore, the current Common Equity Tier 1 requirement equals the Tier 1 requirement, which is 9.6%, including the SREP ratio.

So we have 15.4%, and the requirement is 9.6%. So there's a lot of room here. If we went down to 12%, temporarily, it would be still much higher than the requirement. I'm not suggesting we are going down to 12%, but we could.

Operator

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

László Bencsik - Chief Financial and Strategic Officer

Thank you very much. Thank you for the many questions and very good questions you had. I mean, it's really a very substantial discussion, I think, what we had. So thank you for your interest. Thank you for participating. Thank you for your very good questions.

Wish you all the best, good health. I think that's the most important for the last phase of this virus situation to remain healthy. And then I hope to see you and talk to you, if not sooner than during our next quarterly report, which is going to be somewhere in May. I don't know the exact date, but early May.

So thank you, again, your participation. All the best. Be healthy. Take care of yourself. Thank you very much.

Operator

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