Strategy and Finance Division

Investor Relations & DCM

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Transcript

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

Operator

Ladies and gentlemen, welcome to the OTP Bank 3Q and First 9 Months 2022 Conference call. This conference will be recorded.

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

László Bencsik – Chief Financial and Strategic Officer

Thank you very much. Good afternoon or good morning depending on where you are. Thank you very much for joining us today on OTP Group's 2022 3Q stock exchange report. I hope you have all been able to download the presentation if you wanted to, but using the new technology, we are also sharing the presentation as I speak. I try to be relatively short and focusing on the key points. Then as usual, we'll have a Q&A session.

Starting on Page 2, the quarterly after-tax profit was HUF 189.2 billion. There were not many adjustments, net one-off items were less than HUF 1 billion. It was a relatively uneventful quarter from a one-off's perspective, and therefore, the difference between the adjusted and the actual profit after tax is relatively small. In the adjusted profit, we made 16% quarter-on-quarter improvement. That's also a historic high. We have never had such a high quarterly profit neither adjusted nor unadjusted after-tax profit.

With this, the first 9 months' performance is still below last year's by 31%. The difference is due to 2 factors. One is the direct and indirect effects of the war in Ukraine. Our Ukrainian bank last year in this period made HUF 29 billion profit, this year in the first 9 months, HUF 26 billion loss. So that's one item. As we previously discussed among the one-off items, you can see 2 lines, which are related to the war. That's the impairment of Russian government bonds, which we made in the first quarter and the goodwill and investment impairment, what we also had to book in the first quarter.

The other big one-off hit on us were the various policy measures, which had quite sizable negative impact on our activities. Most of these manifested in the second quarter, namely the big extra tax, which is named as extra profit tax despite the fact that, in Hungary, our core Hungarian operation without dividends is still negative because most of these negative one-offs manifested in the core activities in Hungary. The adjusted profit for the first 9 months was 18% higher than last year including Russia and Ukraine, so with the 2 countries immediately affected by the war, we are 18% up compared to last year.

If you move to the next slide, it's pretty much the same info here. The main performance indicators add some flavour to the picture. The one-off adjusted ROE, including Russia and Ukraine was about 19%. Cost to income ratio improved and risk cost ratio, including Russia, Ukraine was 0.75%. Overall income growth was 18% and operating profit grew 24% year-on-year.

Moving to the following slide: when the war broke out, we made our guidance in early March, we thought that it would be useful for all of us to present our guidance and our numbers as OTP Group without Russia and Ukraine given the high level of uncertainty in those 2 countries. Therefore, we included the overall group performance without Russia and Ukraine. As you can see, this is quite okay: without adjustments there was a 30% year-on-year growth. Compared to the originally guided expectations, basically on all lines, we do better, but I'm going to come back to this on the last page when we talk about guidance.

Moving on to Russia and Ukraine. In Russia, our operations stabilized in the third quarter in the sense of resuming normal levels of lending activity. Just to remind you, we are not a universal bank in Russia. We focus on a small segment, which is unsecured retail consumer lending. Even in that segment, we focus on point of sales loans, which we sell through agents. We are a very small retail consumer lender in Russia. This activity and the demand for POS loans increased in the third quarter compared to the second quarter and the sales levels in the third quarter were close to where they were last year. So, volume dynamics started to restore to more normal features.

The other thing is that the excessive provisioning, what we made in the first quarter, expecting a major deterioration in the portfolio at that time, did not manifest. The macro situation turned out to be somewhat better than we originally expected. The portfolio has not shown any sign of deterioration; therefore, we made the required adjustments in the forward-looking provisioning models. Therefore, we released a substantial part of the provisions that we created after the first quarter.

In HUF terms, we realized an FX gain because we created those provisions on a much weaker ruble rate to the HUF, and we released those provisions, which were made in ruble at a much stronger ruble rate to the HUF and in HUF terms that generated in the next year. With this provision adjustment, we are getting to a level of earnings in HUF terms similar to last year's first 9 months. In fact, in HUF terms, the profit after tax is the same, HUF 24 billion.

In Ukraine, we are still loss-making, looking at the whole year, but the third quarter was slightly positive. The expectation is that unless there's further deterioration of the situation and escalation of the war situation, it is possible that in the forthcoming quarters, we are not going to see further losses on a quarterly basis. Having said that, it is very likely that we will end this year in Ukraine in negative, but it might even be slightly less than what we have accumulated by the end of September.

We included these numbers, the share in the portfolio and so on but the situation now is very much different from where we were in March right after the breaking out of the war. We now more or less understand the type of challenges that we have in these 2 countries and the magnitude of potential losses. Neither of these countries seem to be of high risk in terms of the sustainability of operations there or realizing losses in a magnitude, which would question the ongoing sustainability of these businesses without external support. In fact, some repayments have been done from Russia, from the group funding that started in October, November, so we are reducing the exposure to Russia this way.

The coming slides show the overall performance of the foreign subsidiary banks. The good news is that without Russia and Ukraine, the CEE subsidiaries of OTP seemed to perform very well. The overall profit improvement is more than 30%. That leads us to page 7, where we can see the individual performance of these banks. As you can see, there is a strong improvement in some cases, and some of these banks are getting quite substantial in terms of contribution to the overall performance of the group.

For instance, in Bulgaria, 7% growth, but more importantly, Croatia, 40%, Serbia 45% and Slovenia 36%. Even the smaller banks started to make meaningful and improving profit contributions to the group. Montenegro contributed positively, though the country is directly, negatively exposed to the war situation in Ukraine. Romania is still not making profit, but as we have explained it on multiple occasions, this reflects the strategic approach that we have had for the last couple of years, namely that we are investing into organic growth as opposed to focusing on short-term profitability. The focus remained on profitability, but more mid- and longer term. The expectation is that by next year, we are going to see meaningful returns on these portfolios. It can turn into measurable and material levels of profits.

Talking about the group and the growth of the group, if we go to page 8, we can see the acquisitions. We did one in the third quarter. In August, we closed the acquisition of Alpha Bank Albania. It's a small bank even compared to our Albanian presence, and it does not substantially change our position in Albania. But certainly, this is a country which we very much like and find attractive. The performance of the bank that we previously acquired there has been outstanding. We're very happy that we were able to buy this bank and the merger process already started. Soon, we are going to conclude the legal merge and the operational merger will follow suit.

Then we have the Slovenian story, which has been dragging on for quite long. The good news was in September that the European Central Bank, which is the direct supervisor of NKBM in Slovenia – as Slovenia is a Eurozone country –, approved the transaction. But we are still waiting for the approval of the local Competition Authorities. We are not aware of any outstanding major issue, which could impede the approval. We have not received the results so far, and we are very hopeful that we are going to hear from them soon and that we can close this transaction before the end of the year. To be in this situation is not good for the bank, for NKBM, nor for the clients, it's not good for the seller, not good for us as a buyer. We really don't understand why this process takes so long. It started somewhere beginning of last year. But again, we hope that we are very close to the end of this discussion as well.

There's a new development on the Ipoteka Bank in Uzbekistan. We recently announced that there was a letter of memorandum of understanding signed in October between Uzbekistan state parties who are responsible for the process and our bank. We restarted the process; we are doing another confirmatory due diligence. We think that there is a high probability that the transaction can be made, and we are very motivated and interested in the country. We believe that Ipoteka Bank provides a very attractive investment opportunity. This attractiveness improved since we put the process on hold since March this year after the war broke out.

Going into more details starting with page 9: You can find most of the information here. What important is on this slide and the following slides are the percentage change numbers: the first numbers are the nominal changes, and the second numbers, where we have 2 numbers, reflect the FX adjusted change. In some cases, it's going to be quite substantial. Russia is a prime example, where in HUF terms, even net interest income grew year-on-year by 22%, but in ruble terms it declined. This is important to look at.

Overall, year-on-year 16% growth with Hungary being at 24%, which is almost the highest growth. In Romania we have the aforementioned organic growth strategy focusing on revenue growth, results are quite good. Then Ukraine, where there is obviously a very special situation, the net interest income grew year-on-year and quarter-on-quarter despite the strong volume decline, which is due to the very high-rate environment. The Central Bank is paying 23% on Central Bank deposits and from using these deposits the NII is boosted.

Net interest margin wobbled slightly during this quarter. In Hungary it went down, but in Russia and Bulgaria it went up. Furthermore, there was also FX and composition impact. All in all, NIM contracted by 4 basis points. So that's rather a noise than a major change. In terms of volumes, we had a very strong quarter. I don't remember many quarters, which were so strong. In just one quarter, we grew by 5% and, in some cases, namely Croatia, Hungary, it was even higher, 10%, and 7% growth, respectively. Volume growth was strong especially in corporate, Hungarian corporate grew by 13%, Croatian corporate grew by 17%. These growth rates are strong and are primarily related to the well doing economies, especially Croatia, Slovenia, Serbia, Bulgaria, Romania, where are few signs of slowing down or immediate problems despite high inflation. The high inflation environment creates additional corporate demand. Corporates are stocking up inventories to buy cheap inventory before prices go further up. In general, working capital loan requirements increased substantially. I don't think that this very high level of growth is going to be repeated. It was rather an exceptional quarter, especially in terms of corporate growth. The other important message here is that the Russian portfolio dynamics change. As you can see, consumer loans increased by 3%. That's a substantial difference. We had 2 quarters of steep decline. Then during the third quarter, we had the turnaround in the trend.

Looking at the first 9 months' loan development numbers: the original guidance beginning of March was close to 10% growth for the whole year without a Russia-Ukraine. Without Russia-Ukraine, in the first 9 months, we have been growing by 13% and even including the big drop in Russia and Ukraine, by the end of September, we were at 11%. Exceeding the original expectation in every sense, this is clearly a better picture than we originally believed in the earlier part of the year. Again, some countries show strong performance here.

Deposits: 5% growth in one quarter. Russia and Ukraine started to decline, but this is because we don't need liquidity in Ukraine. We are down to 70% loan-to-deposit ratio. We cannot take out money from the country. We don't need deposits at higher prices. Likewise, Russia: by the end of the second quarter, the loan-to-deposit ratio went down to 105%. Half of the net loan book is financed by equity. The level of capital in Russia is very high. There's not much we can do with the excess liquidity. Therefore, we started to price the level of deposits to the level where we don't have much more growth in deposit levels in these 2 countries. But again, this is due to the very strong liquidity situation in both countries.

The other interesting number is the Hungarian retail growth, which already stopped in the second quarter, but continued in the third, since the rate environment in Hungary is extremely high, and retail clients have access to very attractive and basically almost 100% liquid retail government bonds, tax-free, above 10% fixed or inflation plus percent. These papers are attractive to the level that is impossible to complete with them through deposit rates. This is an understandable phenomenon.

Deposit volumes grew year-to-date by HUF 2.3 trillion without Russia and Ukraine. So even without Russia and Ukraine, we had higher deposit and loan growth. Including Russia and Ukraine, the difference is even bigger. That means that, overall, this year, we increased our loans and deposits.

Page 15, fee income, 14% overall growth, FX adjusted. FX adjusted numbers provide a better picture. In general, this reflects the net fee income growth, the higher inflation, high economic activity, GDP grows typically in all the countries, except Russia, Ukraine, and Moldova. Plus, the relatively high levels of inflation make it not surprising that the fee income is growing quite strongly. In countries like Ukraine and Russia, where economic activity declined, it's also not surprising that fee income declined.

If you go to the next page, which is other non-interest income, the most important line is the last one, because this was a material one-off transaction. We have a venture capital/private equity asset management company, which manages a fund portfolio, and they sold one of their investments with a large one-off gain return, and this is reflected in this strong third quarter number in the other line. The substantial increase quarter-on-quarter is driven by this one-off. In Russia, we had FX gains, and derivative transaction gains, but smaller than the other foreign owned banks present in the country. We don't do much of those activities, it's less and less, and it's getting close to zero.

Operating costs: If you look at the overall number, close to 20% growth without the Albanian acquisition. High inflation, unfortunately, means high-cost growth, especially, if we want to maintain the level of service and competitiveness, what we have, and maintain the capacity to sell and to increase market share. This is the result of the higher inflation environment. But the good news is that the cost efficiency of the group improved despite this year-on-year cost increase. The cost-to-income ratio went down from 49.1% to 46.5% year-on-year. That's sizable. This is the important indicator to look at regarding how cost efficient we are in this high inflation environment.

Going further to capital: Capital situation was stable in the third quarter. Despite of the large profit, there was less improvement, but I have to remind you that the loan growth in this quarter was also exceptionally high, therefore, assets grew. Furthermore, there were also FX movements, which had to be compensated. This kind of 5% growth rate in one quarter required kind of some capital contribution put it this way. Nevertheless, this is quite a strong position, compared to our risk profile and compared to some of our peers.

Looking at the risk parameters, the portfolios have been stable except for Ukraine, obviously. In Ukraine, we are continuously increasing the Stage 3 and Stage 2 ratios, but for the rest of the group, it's declining. As you can see, the Stage 3 ratio declined a little bit during the last quarter from 5.3% to 5.2%. Without Russia, Ukraine, the ratio is down 4.3%. Obviously, Russia and Ukraine are high Stage 3 ratio countries. The coverage has remained relatively robust, especially for the performing portfolio, even without Russia and Ukraine.

Three more slides and some detail on the Hungarian performance. Some notable changes here, for instance, our market share in new production of mortgages have dropped in the third quarter. That's attributable to 2 factors, basically. One is that the green housing loan subsidized program, where we had, as usual, a much higher market share than in market-based products, started to decline in the third quarter as the allocated amounts that we could disburse ran out. Also with the current rate environment, mortgage lending is a negative margin activity in Hungary. You could only sell mortgages lower than the relevant sovereign bond rates for 5 or 10 years, which makes this activity somewhat less profitable.

The other important thing here that the Hungarian deposit book didn't grow. This is also to some extent true for the rest of the market, as you can see, our market share increased during this year from household savings. It's not that the other banks took retail savings and deposit volumes from us, rather the opposite, compared to end of last year we increased our market share in the first 9 months from household savings.

Page 21, Baby loans: still strong. This is a very attractive and very profitable product. The last vintages, the third quarter vintage and the loans that we are selling now, pay well above 10%, closer to 15% subsidy levels, because clients don't pay for the first 5 years the interest. So that is by far the most attractive and profitable product in the group given the state guarantees.

Corporate, Page 22, again, we were quite active in the third quarter, and we have been quite active since the beginning of the year in corporate lending despite a more difficult environment. But the whole market grew fast. Our market share increased by 30 bps in the third quarter and the year-to-date increase is 90 basis points. We believe that this is a long-term profitable segment despite the interim difficulties, especially with the new developments related to the interest rate caps, which were extended for mortgages till end of June next year and are also extended to 5 and 10 years fixed mortgages, which will reprice during this period. The interest rate cap is also extended to SME loans, the impact of which we did not book in the third quarter because these measures were announced in the second half of October, but we included the expected potential loss from this in the interim reports. The expected amount is roughly HUF 40 billion after tax loss calculated on 2 days ago reference rate levels in Hungary. This amount will be booked in the fourth quarter. The expected loss due to these measures depends on the rate environment and rate level. Soon after the U.S. inflation data came out today, Hungarian yields started to plummet. I think there's a fair chance that this extremely high-rate environment in Hungary is temporary, and very soon, we hope to see a moderation in the rate environment.

Our ESG activities remain in strong focus. There is a good development, an objective external reflection on our efforts: Sustainalytics improved our rating from medium to low risk, which is an acknowledgement of our work and the results of our ongoing efforts to improve on this front.

Going to Page 24, this is some update, but it's more of a small cosmetic on the guidance that we made at the beginning of the year in March. At that time, given the very high level of uncertainty, we decided to focus the numeric guidance on the group without Russia and Ukraine. We continue that practice even though today, I think the Russian and Ukrainian business activities are falling back to the more predictable framework, so we could include them as well. And certainly, I am very much hopeful that next year we will include them, and we are not going to have separate figures because they will be much closer to normal levels of operation than we thought beginning of this year.

Nevertheless, we clearly need to update our previous expectations due to the volume growth. We started the year, suggesting that we can be close to 10%. We are above 13%, and we'll very likely to reach around 15% performing loan growth without Russia, Ukraine. Russia started to grow; Ukraine continues to decline.

Net interest margin stabilized on group level. Hungarian margins are still not so strong and short term, not growing, the rest of the CEE operation margins are rather improving due to the higher rate environment. In Hungary, we are still stuck with this large, fixed sovereign bond portfolio and that makes our interest rate risk very low, so earnings don't react in HUF terms to rate changes in Hungary. But they do react to any changes in

Hungary in terms of the euro position, therefore, some improvement might happen, but that will be rather next year than short-term. We remain at this guidance level, which is basically similar to last year.

Regarding cost efficiency, we have seen some improvement, and we hope that this improvement will last for the rest of the year. Risk cost rate, again, without Russia, Ukraine: we had write-backs in the first 9 months, especially the first and second quarters this year. In the third quarter, as you can see, we started to provision due to the deterioration in the forward-looking macro expectations, we made IFRS 9 type provisioning in more countries. This was not due to portfolio deterioration but rather due to the expected slowdown in GDP growth for next year. Then profitability, again, it seems to be higher than last year so far, and we're very much sure that it's going to remain there.

That was pretty much the formal part. I'm very sure you will have many good questions. So please, I'd like to ask my colleague to open the floor for questions.

QUESTIONS AND ANSWERS

Operator

The first question is from Gábor Kemény, Autonomous Research.

Gábor Kemény – Autonomous Research

Hello. Firstly, can we talk a bit more about the Hungarian NII dynamics? I would be interested both in your comments on the margin and the volume outlook. If I understood correctly, you were saying that some margin improvement might be possible next year, if you could elaborate on that? It seemed to me that some of the factors you mentioned, like the large treasury portfolio or the negative lending margins, are likely here to stay. The other question would be on the rate caps. I understand these are moving – I mean, the impact is moving as the rates move. But perhaps can you give us some sensitivities here and what would be the possible impact of extending this rate cap for the second half of next year if rates stay here?

László Bencsik – Chief Financial and Strategic Officer

Okay, sure. We – as usual, don't give guidance for next year at this point of time. We're going to keep that tradition. A more explicit guidance we are going to give, as usual, when we talk about the year-end results early March. We are still working on next year's budget. So, we won't even have the numbers, especially not approved. It would be quite premature to give you guidance, and we usually don't do that.

Having said that, yes, we have corporate sovereign fixed portfolios, some part of it will mature. In terms of euro, in FX, we don't have so much fixed portfolios. We have an open interest rate position there. We are benefiting from increasing euro rates in Hungary and in the other countries, as well. The new mortgage production today is still twice the yield or 3x the yield what it was a year ago. It's lower than the current benchmark, but 2x, 3x more than last year production and almost 2x more than the total book. It doesn't mean from a NIM perspective that this is not positive, but more to come in March.

The rate caps, again, I said HUF40 billion plus. It's not entirely linear, but I think that's the best proxy. The reference rate was fixed at 7.7%. Today, it's around 16.5%. Basically, if the reference rate, BUBOR goes down to kind of 8% tomorrow then it's 0 for corporate. But it's a bit more complicated for mortgages, but this is also similar. Between those 2, the best proxy is a linear function. I hope the eventual loss will not be HUF40 billion, but probably this is the number that we will have to book now and then we will see if there's a decline in the rate environment, which I really expect to happen. Then it's going to be less than that.

Gábor Kemény – Autonomous Research

Got it. And just to follow-up on the euro rate sensitivity. What is it now roughly? And what is it going to be if Croatia joins the Eurozone soon?

László Bencsik – Chief Financial and Strategic Officer

Bulgaria, Croatia, are already – yet not formally – in the Eurozone, the rates there pretty much moved together with the Eurozone. 1 percentage point is roughly EUR 100-150 million per year in terms of NII.

Operator

The next question is from an attendee joined via phone. I opened the line. You will receive an automatic message about it.

Robert Brzoza - PKO BP

Hello. Good afternoon, everyone. Can you hear me?

László Bencsik – Chief Financial and Strategic Officer

Yes. Loud and clear.

Robert Brzoza - PKO BP

This is Robert Brzoza from PKO BP Securities, Warsaw. I have a question on prospective capital requirements. Where do you think within, say, 2 years' time, the minimum requirement will be on the consolidated level, also including the combined buffer requirement for MREL? And where do you see the MREL issuance going forward? And finally, how – and if that's going to affect the prospective dividend pay-out policy?

László Bencsik – Chief Financial and Strategic Officer

The MREL requirement, the obligatory one from starting from January '24, including the buffers and the expected development of the buffers that we are aware of, is 24.2%. Either today or maybe tomorrow, we are going to have a new resolution from the Resolution Board, maybe exactly the same, it might be somewhat different, but we are going to update and make an announcement once we receive that. But we don't expect a major change here. It's roughly 24%. That's our ultimate MREL requirement level. The other change in the requirement is the other systemic buffer in Hungary, which was temporarily - when COVID hit for 2021 - reduced from 2% to 0. This year, it went up to 2.5%, next year it's going to be 1%, and in '24, it goes back to 2%. So that's the biggest moving part. In terms of capital adequacy ratio, by '24, the requirement is going to go up to 15%, including these.

Robert Brzoza – PKO BP

And regarding the dividend policy, do you think that will affect somehow the pay-out compared to, let's say, average?

László Bencsik – Chief Financial and Strategic Officer

In terms of requirements there's no news, right? We don't have any major changes in the requirements. Therefore, the level of the capital requirements does not trigger any change in the expected level of dividends. What is different is the cost of Tier 2, Tier 1Currently, there's, in my view, an extraordinary unique level of risk conversion on the fixed income front. Therefore, rates are exceptionally high. That can have some impact, but I think this is temporary, and I expect the corporate bond rates to start to normalize again, once the overall BUBOR rate development trajectory changes, which might do soon.

In terms of short-term dividend payments, we have not structurally thought about for next year, so there's not much I can say on this front. There are a lot of moving parts. Personally, I am very optimistic regarding the potential changes in the environment, and I expect a much smaller slowdown in GDP activities in the countries than currently expected, but we will see. So again, update on the dividend payments will be done next year, what we will suggest to pay will go to the AGM.

Operator

The next question is from the analyst of Morgan Stanley Oto Dgebuadze.

Oto Dgebuadze – Morgan Stanley

I wanted to ask about your proposed transaction in Uzbekistan. Namely, what changed since April when you postponed the deal? What made you turn more positive? And generally, what's your view, thoughts on the macro in the country? They have quite ambitious targets in terms of privatization. FDI is generally liberalizing the economy. I am interested to hear your thoughts about the transaction and the general economy as well.

László Bencsik – Chief Financial and Strategic Officer

The general economic situation improved, and they very rapidly progress on the path what they decided to go through – and this is very visible, since the beginning of the year, in terms of new developments, real estate prices, economic activity in general. The value proposition of the bank itself improved a lot. They came up with a very modern state-of-the-art mobile banking solution, which, I think, competes with the best in Europe in terms of service level. And that was just a development during the last 8 months. Geopolitically, I think, Uzbekistan positioned itself very wisely in this conflict, and the geopolitical attractiveness of the country improved. They accelerated their efforts to move the economy into a market-based environment. They seem to do what they say, and evidence is accumulating. I think this is a very good sign.

Numerically, we expect more than 5% GDP growth for next year as well, where most of Europe is going to slow down. They have inflation, which they consider high, but it's already lower than 10%. When looking at European inflation levels, it's lower than in the Eurozone. Nevertheless, the expectation is that it's going to be further reduced. Compared to the inflation level, they have a somewhat higher base rate environment, which they expect to moderate. Just today, our Prime Minister and a big Hungarian delegation, including my colleagues from OTP, are there on a regional forum.

There are a lot of bilateral discussions between Hungary and Uzbekistan. And Uzbekistan and other countries. They improved their political relationship with the neighbouring countries dramatically. I was there last week, and I was quite impressed.

Oto Dgebuadze – Morgan Stanley

Do you have any target timeline of closing the deal?

László Bencsik – Chief Financial and Strategic Officer

If it's up to us, the sooner the better.

Oto Dgebuadze – Morgan Stanley

Great. Speaking of inorganic opportunities, earlier, you also mentioned something in China. Is there any update that you could share at this stage?

László Bencsik – Chief Financial and Strategic Officer

There is a potential for setting up a joint venture, where we would be a minority investor. We are still focusing on trying to get the license. We are still at this early stage. The most difficult part seems to be to get the license. And so no, there's nothing I can tell you as an update, but we're still working hard on this, we are making small steps, but it's a long run.

Oto Dgebuadze – Morgan Stanley

Lastly, continuing on the same path. In Slovenia, are you aware of any issues that is holding off the final approvals? Or do you feel you are on track for closing?

László Bencsik – Chief Financial and Strategic Officer

We are not aware of any issues. They communicated to us that they don't require further information. We are not aware of any issue. There was one concern they had, a year ago, they told us that we have to completely change the structure of this transaction, and we addressed this particular concern, 8, 9 months ago. Since then, we haven't heard of any tangible problem.

Operator

The next question is from Alan Webborn from Societe Generale.

Alan Webborn – Societe Generale

Could you elaborate a bit more on the trends in provisioning in Hungary in the core business in the third quarter? Was this a sort of pre-emptive cautionary IFRS 9 related? Just give us a little bit of a flavour there. I know overall, you're talking about risk costs being made below what they were in the full year of 2021 now. But just to give us an idea of what was going on in Hungary in 3Q, that would be helpful.

László Bencsik – Chief Financial and Strategic Officer

It was exactly what you just mentioned. It was a forward-looking IFRS 9 related provisioning due to the GDP development. Unfortunately, and I hope this is going to be better, the consensus view is that Hungary will not perform as good as the neighbouring countries in terms of GDP next year. We had to reflect this in the IFRS 9 forward-looking provisions. I'm more optimistic than this. But obviously, we have to rely on typically external sources when we talk to our auditors regarding the macro expectations.

Alan Webborn – Societe Generale

But would it be fair to say that you've perhaps done in 3Q what you would traditionally tend to do in Q4?

László Bencsik – Chief Financial and Strategic Officer

Every quarter, we have to do this exercise, right?

Alan Webborn – Societe Generale

Yes. Okay. But I guess what happened in 3Q was more unusual in terms of what happened to rates and so on.

László Bencsik – Chief Financial and Strategic Officer

Yes, absolutely. This is just related to the worsening macro expectations, not just in Hungary, but across the countries. Expectations are more negative in Hungary than, let's say, in Slovenia, Croatia, Romania, Bulgaria, Serbia. In these countries, we also expect some slowdown in GDP growth. But in Hungary, the slowdown will be - according to the - external forecasts - much more pronounced and maybe even recession is going to happen in Hungary. These expectations were formed during the third quarter, and therefore, we had to reflect it in the IFRS 9 provision.

The portfolio did not deteriorate. It was not because there was a strong migration to Stage 3 or something like that.

Alan Webborn – Societe Generale

Okay. Understood. Could I also ask – I think you mentioned that you've been able to reduce the group funding to Russia. Did I hear that right? And if so, how did you do that? I didn't think it was possible to repatriate anything from Russia at the moment. Could you just say how you've managed and what you did to do that? That was the second question.

László Bencsik – Chief Financial and Strategic Officer

Since late summer authorities became more open to close expiring deals. So it's not that we took out something, there were just some loans which expired and it was possible to pay them back.

Alan Webborn – Societe Generale

What you're saying is, so the Russian business was allowed to pay back loans to the group?

László Bencsik – Chief Financial and Strategic Officer

Yes. It started, yes.

Alan Webborn – Societe Generale

Okay. That's interesting. Finally, just to come back on Uzbekistan. I hear your enthusiasm clearly. Clearly, there's a broader agenda between Hungary and Uzbekistan. But when you slowed down the idea of that deal earlier in the year, you referred to it as being outside of your comfort zone in more difficult times. And clearly, the situation, as far as the geopolitics in Russia are concerned, haven't changed. and you reiterated what you think the cost of having to walk away from Russia would be in terms of your CET1. The chances of that happening don't seem to have really changed. This is moving ahead. Are you now an exclusive partner? Because I think when you slowed the deal down, the state could have gone and sell it to somebody else if they wanted to. It sounds as if you're more committed now. What has changed? Is it just that the operation and the business is so much better than it was when you first looked at it? Or are you more comfortable with the group's level of core Tier 1? What's changed? Because the geopolitics, if anything, is worse, it's not better, is it?

László Bencsik – Chief Financial and Strategic Officer

I guess it's subjective and depends on from where you look at the situation, but I think from a geopolitical point of view, Uzbekistan became more attractive than before. I think the way they position the country during this period, improved their geopolitical attractiveness. And this is not just my view. When I talk to other investors, who consider the country, it is visible, there is low buzz related to the country. You are right that the war is going on. If anything, it has escalated and reached tragic levels. But compared to where we were at the end of February, when we temporarily put the process on hold, we have much more understanding now in terms of how this conflict develops and what the implications on our businesses are in Russia and Ukraine. As I said, in Russia, the business is going okay. It's a very basic plain vanilla business focusing on consumer lending, makes money. It doesn't require capital, doesn't require funding, and is quite profitable.

In Ukraine, unless there's a major deterioration of the situation compared today, which I do not expect, then we might not have more losses. This is a major change compared to where we were in March. We didn't know what was going to happen with our banks in these 2 countries. So yes, you're absolutely right. The overall geopolitical attention and problems have not been resolved, but regarding the very specific situation of our banks in Russia and Ukraine, there's much more visibility, clarity and they stabilized and adapted to the new environment.

There is much less uncertainty from my point of view.

Alan Webborn – Societe Generale

Okay. But at the same time, it's going to be a more expensive acquisition, isn't it?

László Bencsik – Chief Financial and Strategic Officer

If you forgive me, it's a deal which have not been made.

Alan Webborn – Societe Generale

Yes. But it's going to be more expensive?

László Bencsik – Chief Financial and Strategic Officer

It is quite unusual that we share so much and talk openly about something which we have not concluded yet. I don't think I should disclose this type of detail.

Alan Webborn – Societe Generale

Okay. But the HUF is weaker, and their business presumably is developing more strongly.

László Bencsik – Chief Financial and Strategic Officer

Yes, HUF is weaker, and they develop strongly. Those statements are true. I And I hope the HUF will appreciate soon. And their businesses will continue to develop. So yes, that's true.

Operator

The next question is from Mehmet Sevim, J.P. Morgan Securities.

Mehmet Sevim – JPMorgan Chase & Co

I have just one follow–up on the Hungarian NIM, if I may. I do appreciate you are unable to provide too much colour on 2023. But from a quarterly perspective, maybe, how would you see it evolve in the fourth quarter after this sizable 23 basis point drop? Particularly because there seems to be a loan pricing delay among others, as you provide in the comments.

László Bencsik – Chief Financial and Strategic Officer

I don't expect a similar drop in the fourth quarter. There is a time lag we have between the deposit and loan repricing. There is the cap on the interest of the variable loans for part of the portfolio but that doesn't appear in the NIM, because upon the introduction of the caps, we had to book the full expected amount or impact, when they are announced, so we show them as one–offs. So, the actual caps don't have an impact on the NIM. They come through as one–offs. But I don't expect a similar decline.

Mehmet Sevim – JPMorgan Chase & Co

But certainly, some further decline is possible. Is that correct to assume?

László Bencsik – Chief Financial and Strategic Officer

There's always some noise, but not similar level for sure.

Mehmet Sevim – JPMorgan Chase & Co

Okay. Great. And if I may have a second question, and that will be on Croatia. Do you see any opportunities or pressure points across the P&L lines once they enter the Eurozone? And maybe, for example, in the fee line, FX fees, et cetera.

László Bencsik – Chief Financial and Strategic Officer

Yes, absolutely. The FX conversion income, fee income is meaningful there given the tourism. But I think the benefits will are far outweigh this negative, especially mid to long-term.

Mehmet Sevim – JPMorgan Chase & Co

Okay. Great. And if I may, just finally, any colour you can provide on the NIM drop in Romania and particularly Croatia? I was interested, given obviously, the rate trajectory in the Eurozone at the moment.

László Bencsik – Chief Financial and Strategic Officer

It's related to the past corporate loan growth, right? Corporate loan growth is extremely strong. Corporates have typically lower margins than the retail.

Operator

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

Hai Thanh Le Phuong – Concorde Securities

Thanks for the presentation. I have a question on your asset quality moving to 2023. I know that it's pretty hard to forecast anything or to say anything, but excluding Ukraine, Russia and particularly Hungary, could you share with us what is your view on non-performing loans? Are we talking about, in the worst case, the doubling NPL or it will grow but maybe not significantly? What is your view on that?

László Bencsik – Chief Financial and Strategic Officer

Certainly, the expectations are very far from doubling. I don't see that scenario. The risk cost rate this year for ex–Russia, Ukraine countries was quite low. And it's going to remain low. Last year was quite low. So compared to last year, this year, there will be an increase in the risk cost rate, but we don't expect anything dramatic.

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 so much for joining us today and listening to the presentation and thank you for your very good questions. The next conference call will be when we present the year-end numbers early March. I hope you will join us for that occasion as well, until then, all the best, and goodbye. Thank you very much.

Operator

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