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Presentation

Operator

Ladies and gentlemen, welcome to the Swedbank Second Quarter Report 2017. Today I'm pleased to present Gregori Karamouzis, Head of Investor Relations. For the first part of this call, all participants will be in listen-only mode. And afterwards there will be a question and answer session. Speaker, please begin your meeting.

Gregori Karamouzis

Thank you and good morning everyone. Thank you for joining our conference call for the second quarter results. With me I have Birgitte Bonnesen, our CEO, Anders Karlsson, our CFO and Helo Meigas, our Chief Risk Officer. I'll hand over to Birgitte to initially, Birgitte?

Birgitte Bonnesen

Thank you, and a warmly welcome so this strong Q2 quarter result. We deliver another quarter that has been very much characterised by both focus and execution. Profitability is strong and activity very high. We saw increased mortgage volumes in both Sweden and the Baltics which contributed to our higher NII. The demand for corporate lending is modest apart from real estate, and we saw a slight decrease in the quarter. Net commission income was up given a high activity in payments and cards as well as a strong stock market. This resulted in an increase of 6% quarter-on-quarter.

We still see inflow from the retail network into our asset management and we're very pleased about that, but we all – and we're very pleased about the inflow into the new funds that we have launched this quarter. One of them was the Microcap fund that reached almost a billion in the first period that they were out there. It's – and we – but we see outflows on the institutional side. Bottom line we have an RoE of 15.6 and a cost/income of 0.38 which is very strong. As I mentioned to you before we have a plan, a wanted position that we articulated last year. We will continue to develop as the leading retail bank with four home markets. This position has been articulated now into segments strategies, private and corporate, a channel strategy as well as core products strategies.

This gives us a very clear guidance in prioritisation of investments and activities. And I would like to highlight three important strategic initiatives in this quarter. First of all payments, payments is a very important product area in Swedbank and this quarter we decided to enhance our own offering of payment services with the acquisition of PayEx. PayEx is one of Sweden's largest providers of e-commerce solutions, but they also have a Nordic platform and operations in all of the Nordic countries. The aim of the acquisition is to enable a market leading Nordic-Baltic omni-commerce offering, and meet the customer where they want to pay regardless of channel or payment method.

It also includes the retail finance capability. We got the approval from the Swedish competition authorities last Thursday and we're waiting for two more. One is the Swedish FSA and another one is the Norwegian Competition Council. PayEx has a very innovative spirit so this is something that also adds very much to our own setup. Secondly, you saw that we entered a strategic partnership with Kepler Cheuvreux this quarter. This means that we will source equity research corporate access and institutional equity sales capabilities from Kepler. The aim is of course to offer an ECM product to our customers that are far more competitive that we could have ever done on our own.

And the third strategic corporation that I would like to mention is with a small Swedish fintech called Mina Tjänster. It offers a service that facilitates management and monitoring of subscriptions and other recurring agreements. It really adds value to our customers and they will be able to find best offers for e.g., for mobile subscriptions, electricity or insurance contracts in the Swedbank app. And we definitely see this as the way of the future, finding things that complement our own offering of financial services. And you will continue to see us make smart choices and complementing our own innovation capacity with external collaboration, and all leading to what's remaining a leading retail bank.

And basically strong profitability capitalisation and efficiency, it's not only a very good start, but I think it's really crucial for us to continue this good development of the bank. And with this, I'll handover to Anders to take us through the financials in more detail.

Anders Karlsson

Thank you Birgitte. I will start off as always walking you through the three business segments and thereafter sum it all up to the group level before I finish off with the capital situation. Swedish banking delivers a strong result across all income lines. NII was positively impacted by increased mortgage loan volumes, improved deposit margins and lower resolution fund fee. The extra day in the quarter, as well as high corporate margins on the back of the repricing of the specific leasing and investment loan portfolio in March, also contributing.

Mortgage loan volumes were up with 12 billion in the quarter and we captured around 20% market share in new lending. Corporate loans were down somewhat due to a few larger repayments at the end of the quarter. Mortgage margins were stable in the quarter. We foresee the back book margins for fixed mortgages to continue expanding everything else being equal as we have around 150 billion in fixed mortgage coming up for repricing over the next 18 months. The margin differential is around 10 to 15 basis points after recent changes in list prices. Deposit volumes were up due to tax refunds and dividend season.

The positive stock market development combined with a more favourable asset mix improved asset management income, and higher customer activity improved income in cards. Stripping out the 680 million one-off gain from the sale of Hemnet booked in the first quarter, other income benefited from higher activity in EnterCard, our joint venture credit card business. Asset quality continued to be resilient. Baltic Banking achieved another solid result. NII was positively impacted mainly by one more day and FX effects, but also from higher average loan volumes as private lending continued to increase. Lending margins were stable. Net commission income was positively impacted by higher customer activity in cards and asset quality continued to be solid.

Lastly looking at LC&I, Large Corporates and Institutions result improved in the second quarter. NII was up impacted positively by low resolution fund fee one more day in the quarter and improved the deposit margins as we charge to more customers to compensate for negative interest rates. Net commission income was supported in the quarter by higher activity in cards and debt capital markets while income from brokerage was weaker. Net gains and losses were stronger compared to last quarter as FX trading picked up. Also valuation effects in derivative exposures quarter-over– quarter impacted positively.

Equity trading was weaker due to lower activity around the time of the French election. Credit impairments in the quarter was somewhat lower than in Q1 and yet again came from provisions in the oil related segments. Helo will talk more about the outlook in the oil and offshore portfolio in a short while. So to summarise on Group level, this quarter again we demonstrated a robust profitability and continued high capital generation. We were able to continue growing our mortgage loan book while keeping margins stable. Corporate margins increased slightly in the specific corporate portfolio mentioned earlier, but otherwise remained stable in the SME segment and under pressure in the large corporate space.

Deposit margins benefited slightly from higher Stibor rates. This quarter, we also got the final fee level from the Swedish National Debt Office that we have to pay for the resolution fund for 2017. The level for the full year became lower than we anticipated in the beginning of the year and we'll end up around 1.2 billion in total. Also the new fee level decided by SNDO for next year will lead to around 450 to 500 million higher fee for us. Commission income was stronger on the back of higher activity in cards and positive asset performance. Net gains and losses improved mainly as FX trading picked up.

Group Treasury's result was in line with our previous guidance where NII and NGL income combined in 2017 is expected to be around the same level as in 2016 excluding the one-off gain of the Visa transaction. Total expenses came in as expected. When the PayEx acquisition is finalised, most likely during the third quarter, we will come back and revise our cost targets for the full year of 2017 to also take into account the consolidated result of PayEx and various acquisition related expenses. Our intention thereafter is to, in conjunction with the publication of the Q4 result, to guide you on the expenses development going forward.

Looking at the loan growth expectations for the year, we note that the corporate activity was high in the quarter, but we saw a couple of larger repayments at the end of the quarter. Loan demand in sectors other than real estate remained low. Also we see the trend from last few years continuing where corporates to a larger extent turned to the capital markets or used own funds to finance investments. As a result we saw a good activity in DCM this quarter as mentioned earlier. With regards to expectations for the remaining part of the year, we have a solid pipeline in the SME segment and expect to grow in line with our ambition.

On the other hand, the continued loan demand from large corporates is expected to lead to slightly lower loan growth than anticipated in the beginning of the year, and we will not prioritise volume ahead of price or risk. Loan growth expectations for the full year in the Baltics continue at a healthy level. Turning to capital, capitalisation remains strong with the CET1 capital ratio of 24.6. Our own estimation of our minimum capital ratio requirement based on all by the Swedish FSA decided requirements and current risk exposure amount hence the 22%, which gives a buffer of around 260 basis points.

We still await clarity on primarily expected Basel proposal and the subsequent implementation by the EU before we will set our management buffer level. The CET1 capital base was again this quarter negatively impacted by the pension liabilities valuation amounting to 400 million. Risk exposure amount decreased by 4 billion. We had two IRB model implementations in the quarter, one reducing REA and the other one increasing it. The acquired mortgages from Sparbanken Öresund moved to advanced IRB, and as a result reduced REA with 6.5 billion. This effect was more than offset by the implementation of Foundation IRB for sovereign and central bank exposures increasing REA with 7.5 billion.

In addition, we saw positive PD migrations and collateral valuations that reduced REA with 5.9 billion. Let me now hand over to Helo to walk you through the asset quality.

Helo Meigas

Thank you, Anders. I shall now give a short review of credit quality in Q2. Volumes continued to grow in all our home markets due to strong demand from private lending whereas demand among corporates remained subdued as of was also mentioned earlier by Anders. Private lending volumes in Q2 grew by SEK 14 billion while in corporate portfolio, there was a slight decrease. We continue to have a strong credit quality in our home markets. Swedish banking reports credit impairment of SEK 86 million and in Baltic banking credit impairments were 7 million krona.

In large corporates and institutions, we increased credit impairments by SEK 307 million mainly due to additional provisioning in the oil and offshore portfolio. This is in line with what we communicated during the previous quarter as restructurings progress we adjust the provisioning when needed. As to the guidance for the total year was 10 to 15 basis points credit impairments to the total credit portfolio, we are not changing it for the time being. We do have an improved visibility regarding our oil and offshore portfolio in terms of which clients will be able to take them, themselves through the downturn and who may need to use delivery restructuring with an injection of new capital, but we want to wait before we come out to the changed guidance as these discussions are still ongoing. I stop here.

Gregori Karamouzis

Thank you Helo; and we are happy to take any questions, so operator, please pass through the questions.

Q&A

Operator

Ladies and gentlemen if you have a question for the speakers please press 01 on your telephone keypad and you will enter a queue. After you are announced please ask your question. And our first question comes from the line of Peter Wallin from Handelsbanken. Please go ahead. Your line is open.

Peter Wallin

Yes, thank you and good morning. I would like to start with maybe a clarification. If I understood you correctly Anders, you are lowering your volume growth expectations for corporate lending this year, but you're also saying that you're going to be focusing on margins and risks so. Does that mean that you expect to have higher margins than what you did previously or is it just a slightly lower volume outlook? And if you could please guide what kind of expected volume growth for total lending it's reasonable to assume for 2017 now?

Anders Karlsson

Thank you. Now what I meant was that really that we see that still – the most of the demand comes from the real estate sector. We have been very clear that we have been a bit more cautious in that space as – and that this is also a sector where you see that the – they are attracted to the using the capital markets for funding. So what I'm saying is that the competition is high out there. The loan demand is still low and we will not go into deals changing our origination standards or our return targets so – but at the same time the activity is high so if I want, if I am to guide you for the loan growth for the year, it's still – including the private side – we expect to end up around 4% or something like that.

Peter Wallin

Okay thank you. And to some extent on the kind of the high activity levels seen in the quarter, would you say that those were maybe even higher than expected so that to some extent the volume growth you're not seeing as expected from corporates and in terms of lending, this is reasonable to assume that you'll still see that kind of activity supporting your DCM to maybe higher extent than what you saw three months ago?

Anders Karlsson

Not really. When you look at – what you see is the net lending figures and it looks like our portfolio is decreasing in those terms, and that is actually the fact – or is flattish. But what I mean is that some repayments are there, but there are new customers and new volumes coming in. But again coming back to the capital markets, what we see is that corporates – the ones who have access to it – use it, which is good from a DCM perspective. And many of them are very strong financially so they use their own funds to cater for new investments in new capacity; that is what we have seen so far.

Peter Wallin
Okay and then if I could just ask one question on the mortgage margins and the outlook there maybe especially. At the end of the quarter, we saw that one of the more price aggressive banks, Danske bank last week raised list prices in Sweden. Do you think that the level of price competitiveness in the Swedish market, this is slightly slowing down right now or do you see any change – I mean trend shifts?

Anders Karlsson
Not really Peter. I would say it's still high and continuing.

Peter Wallin
Okay, thank you. That's all for me for now.

Operator
And our next question comes from the line of Magnus Andersson from ABG. Please go ahead. Your line is open.

Magnus Andersson
Yes, good morning. First of all, I have a couple of questions on NII. First of all a follow-up to Peter's questions about your lending growth here. When I look at your book we see that private customers growth nicely is up 3% year-to-date while it's corporate as you pointed out that is actually down. And we can see that it's primarily commercial real estate in the property management portfolio. At this stance, my question is, is that – is there is deliberate element in here of reducing that part of portfolio and if that is the case, is it primarily done from a risk perspective or that you feel you don't really get the profitability you would like to have after that segment; i.e., is there an element of phasing out less profitable volumes also?

Anders Karlsson
Okay Magnus, to start off, no it's not about deliberately getting rid of volumes. If you look at the real estate or the commercial real estate segment, we have said clearly that we will work with the customers we have. We have enough of them. They are large. We know them very well. Some of those are cautious as well at this point. We have also said that we will not and we do not need to chase new volumes. So it's not a deliberate decrease and we stick to the strategy we have in the real estate space. And then what you have seen in the quarter, a couple of the larger ones, have actually moved into the capital market. So it's a combination of those two things.

Magnus Andersson
Okay thank you. And then just if I continue on the corporate lending margins we know that you repriced part of a – smaller part of your book where you had fixed pricing. But and last autumn we talked a lot about potential repricing of the remaining parts of the corporate lending books and capital requirements increased. How do you look at that now? Is it really possible to reprice anything when volumes are not growing?

Anders Karlsson
To start off with the first one, it was not fixed price. Actually, Magnus it was administratively separate so it was not connected to Stibor, and but that's right. We did that and we – that was quite a successful action. As far as the other part of the portfolio comes, it seems to be – we are working with it, but it is very difficult to reprice at this point in time.

Magnus Andersson
Okay finally just my favourite question on the NSFR, it continues to increase. It's now 110. Sorry, yeah the net stable fund ratio and we see that you are required stable funding, funding remains stable while your ASF[?] is increasing. And you previously talked about this target of 103 to 105 while it continues to increase. What – do you have any kind of time frame for when you think you would start reducing this?

Anders Karlsson
Thank you, Magnus. I really appreciate that question.

Magnus Andersson
I know.

Anders Karlsson
But seriously, as you know we have funded – we expected to have a funding plan of around 200 billion for this year. And that is based on the projections on growth and also the maturities in the book. We have had a very benign environment in the

beginning of the year, so we actually issued more than 120 billion in the first half, which is aggressive, but it was part of the strategy. And we have not seen the loan growth that we expected at the same time so we are revising the funding plan regularly as we speak. My ambition is to get down to 103 to 105 range as quickly as possible.

Magnus Andersson
Okay thank you very much.

Operator
And the next question comes from the line of Andreas Håkansson from Exane, BNP Paribas. Please go ahead. Your line is open.

Andreas Håkansson
Yes, good morning everyone. Just a quick follow up on Magnus' question on NSFR. And is it still a 100 million positive each basis points there? So should we see an improvement as and when you start to move in that direction on NII? Then the next question, if you look at your sensitivity to rising interest rates we've seen another quite big increase in that sensitivity in Q2 over Q1 and it's a 33% increase since the beginning of the year. Could you tell us a little bit what is driving this continued improvement and should we expect that improvement or that increase to continue in coming quarters? You can start with those NII questions. Thanks.

Anders Karlsson
Okay Andreas, and the previous guidance around the NSFR effect of around 100 million is due to spreads coming down to 50. I have – I need to add to that that there are some technical restrictions in there. If you remember we had a large drop in Q3 last year that was due to the fact that two bonds went into the 12-month and six-month window at the same time. So there are some technical issues there that is so you cannot translate immediately into NII, but the spreads have come down so the answer is not 100, it's 50.

And on the other, the NII, I leave it to Gregori.

Gregori Karamouzis
Yes Andreas, I think it's – you should consider that the whole balance sheet is taken into account when you look at the sensitivity. So the duration of certain positions impact and at the measurement point which is the end of the quarter. We in this particular case, we have entered in some position with a different duration in the last quarter and that gives a bit of a jump in the sensitivity. So there's – it's a technical basically reason why it increased this quarter.

Andreas Håkansson
Okay thanks. And just a question on your trading result, we've seen the other as Nordic banks have reported quite weak trading in the quarter and talk about very low volatility as we all know. You reported on the other hand a very good trading result. Could you tell us what you would consider to be a more of a normalised level for you guys?

Anders Karlsson
Yeah Andreas, I think we had a fairly rough start Q1 so the improvement you see quarter-over-quarter is actually FX trading picking up to the level that we expect it to be. So it's very difficult to guide on the NVL[?] as you know, but I would say that Q2 is more in the normal space than Q1 was.

Andreas Håkansson
Okay thank you very much.

Operator
And the next question comes from the line of Willis Palermo for Goldman Sachs. Please go ahead. Your line is open.

Willis Palermo
Hi, good morning. Thanks for taking my question. The first one is on still on the volume growth on the corporate side whereby you mentioned a strong pipeline to come. I was just wondering if you could describe it and where you see it coming from.

Gregori Karamouzis
Willis, could you just repeat the question. It was interrupted so we didn't hear exactly what you said.

Willis Palermo
Hi. I was just wondering if you could describe the strong pipeline you mentioned for corporate lending volume growth.

Gregori Karamouzis

Thanks. Birgitte?

Birgitte Bonnesen

Yes, what we see there is a strong pipe is, it's actually broad-based. It's Swedish banking in the retail we have a different way of working that we introduced in the beginning of the year and the activities resolving and we see more deals coming in. But it's broader-based and it's also, you know, when you move from real estate into other areas, the volume may not be as high. And I think that you need to factor in that thing too.

Willis Palermo

Okay so it's more in term of client number than magnitude of the lending per se?

Birgitte Bonnesen

Yes.

Willis Palermo

Thank you. And the second question on the net interest income and the pricing of the longer maturity loan, could you describe a little bit how the competition is – how do you position faced to the competition because it seems that the other player are moving in the other way around. So what's the rationale behind it and how – and do you think if there is a risk of losing market share or any change in that or do you have the same demand despite the increase in pricing?

Anders Karlsson

I'm not entirely sure I understand the question. But if you look at the mortgage loan book, it consists of – roughly 70% is floating rate, which is repriced more or less continuously with the three months fixing and then you have a remaining back book of around 150 billion that comes in for repricing or resetting in the next coming 18 months. When they were originated, they were originated at a lower level than we see today. And I don't think that we are doing anything differently than our competitors. So I'm not sure what you're alluding to.

Willis Palermo

I was just wondering around the [inaudible] but for the three and five years if you're moving in line with everyone else. Is it just a trend of everyone moving up its pricing for longer durations?

Anders Karlsson

The dynamics you've seen recently is actually in the longer term where most banks have decreased the list price. So when I talk about the repricing it's about the fact that when these loans that was originating a long time ago are coming in, the new levels are higher than the original ones.

Willis Palermo

Okay I understand. And then the last question is on the loan loss provisions. Could you give maybe some more colour on where you stand in term of restructuring if we can consider this quarter in the end because it was a bit larger than previously in the first quarter or if you still continue to see some conversation with clients where you'll have to take some more provisions?

Helo Meigas

As we have been discussing we have, basically a first phase of restructurings which is more or less over by now. We are still in the process of finalising one of the discussions, and that because also might affect provisioning a little bit although we – I think there's quite a bit of visibility by now already. But then we see as the market is not really improving to the extent that may be was expected at the beginning of 2016 so we are starting to enter into the second phase of restructurings. As it looks now, it is more about further prolongation of maturities of the loans, not necessarily increased credit impairments. But as I said I don't want to guide at this stage. We expect to see more visibility through the year and also we are very much of course aware that the investments are not picking up in the sector as yet. So we need to kind of see how the oil price develops in the second half and then that will have an impact on also on the total factor at large.

Willis Palermo

Okay; thank you very much.

Operator

And the next question comes from the line of Matti Ahokas from Danske Bank. Please go ahead. Your line is open.

Matti Ahokas

Yes, good morning, two questions from my side as well. Anders, could you repeat what you said regarding the mortgage margin in Sweden? The line was a bit bad. I didn't get it; understood that you were increasing mortgage margins in Sweden or was that correct? The other question is regarding the credit quality still. It's quite surprising that you're keeping the guidance of 10 to 15 basis points taken into account that leaves many of your peers are saying that the on offshore industry situation is improving. Is it because that you're seeing problems, bigger problems in the old exposures are, are these kind of new problems from new exposures or how should one look at this because obviously it looks at least that the situation should be improving or are you just conservative by keeping the 10 to 15 basis point guidance? Thanks.

Anders Karlsson

Okay thank you. No, what I said is that the mortgage margins were stable. The repricing that are still to come is in the part of the book that is fixed rate, and that is rolling in gradually over the next coming 18 months, and that amounts to around 150 billion, so all else being equal that will have a positive repricing. Other than that, margins were stable in the quarter.

Matti Ahokas

Got it.

Helo Meigas

Following then on the credit quality and the market outlook in the oil and offshore, we don't see that it's really necessarily improving. The oil price is still at a very low level. Yes, we do have some positive signs in terms of higher number of enquiries for rigs and some new contracts signed, but at very low levels as so we believe that we need to see how the oil price developed before we can say that the – that we are out from the stormy waters so to say, but we don't have any problems in the – in our current book in terms of the restructurings what we have made.

The companies are performing as expected. It's more regarding the outlook going forward that we are we are very cautious about. And we are a bank. We are very cautious to change its guidance and so we do it when we see that there is a real underlying reason to do that so we'll come back when we feel that we are out from the problems.

Anders Karlsson

And just to remind you, most of these exposures are syndicated loans so it's – all banks are in sort of in the same situation more or less.

Matti Ahokas

All right, I have a quick follow-up in the Baltics, the credit quality is now, are now the write-backs over and we're kind of approaching gradually normalised run rate of loan losses?

Helo Meigas

Yeah, we have been saying that's the write-backs are over. But if you look at the also the amount of impaired loans and the provisioning levels there isn't that much left any more. So you, I mean of course the overall credit quality is very good there, so we see limited new impairments coming in. So there's a total kind of pluses and minuses are small so you still end up being at zero so don't expect anything significant anymore.

Matti Ahokas

Great thanks.

Operator

And the next question comes from the line of Jan Wolter from Credit Suisse. Please go ahead. Your line is open.

Jan Wolter

Yes, morning all of you. Jan Wolter here Credit Suisse so a couple questions there on funding and NII. Is the funding cost going forward – is that coming down you think when you look at the maturities that the bank has? We can see that I think in the second half at least 30 billion or so of senior funding maturing so that's my first question.

Anders Karlsson

Okay Jan, thank you. I think it is extremely difficult for me to have any good prognosis on the spreads going forward. It has been benign, but it's volatile as you know. So I wouldn't do any projections on that.

Jan Wolter

Okay now fair enough. And then I think you mentioned on the call, either you Anders, or Gregori on the NII sensitivity increase in the quarter alluding to taking positions or something along that line. Has this impacted the NII now in the second quarter maybe in particular the Treasury NII or do you think it will impact the NII conceptually going forward, and just give some more colour on what those taking positions – what that means?

Gregori Karamouzis

No Jan, it hasn't – what we mean is that we – it's a total balance sheet that we look at and it swap positions into straight positions of different kinds and duration of those positions vary over time. So depending on when you measure the sensitivity, it can be higher or lower and that is what happened at the end of this quarter when we provided the measurement of the sensitivity. So it hasn't impacted the P&L in the quarter.

Jan Wolter

Okay thanks, and then I think you alluded to some repricing on the SME segment, but that was the administrative, the levels with the administrative rates. When you look forward now, just not just in the second half, but into 2018 perhaps so in a 12 month period, would you still expect that we'll see meaningful repricing of the loan book if we exclude obviously the large corporates and the mortgage book or how do you see that going forward given that we've seen now quite a few – quite a lot of increase in capital requirements both coming from sovereign risk weights and corporate risk weights and higher resolution fund fees? Thank you.

Anders Karlsson

Yeah, thank you Jan. The sovereigns I think is extremely difficult to reprice. It's Federal Reserve and the European Central Bank and the Swedish government so. Leaving that aside, we said it before our ambition, we have a clear return target. Our ambition is to price, increased costs; whether it is capital increases or if it's a resolution fund increase, we definitely have the ambition to do that. We think it is rational to do it. But with a market with high competition and subdued demand, it is extremely difficult to do that. So bringing you into 2018 giving you any projections on that is that would be stupid of me. I can't do that, but that is our ambition and it has been all the time.

Jan Wolter

Okay that's fair. And I think just finally another question which I understand it's very difficult to answer, but also that I think you previously talked about Treasury NGL[?] and NII together unchanged vis-à-vis 2016. Is that still your view the most likely outcome?

Anders Karlsson

Yes.

Jan Wolter

Okay, now that's very helpful. Thank you.

Operator

And the next question comes from the line of Yafei Tian from Citigroup. Please go ahead. Your line is open.

Yafei Tian

Thank you very much for taking the question. I have a question on operating expenses. So in the call you mentioned that this would be revised as we have more clarity on the PayEx acquisition. But assuming that we are leaving the PayEx acquisition outside the equation you had a cost target of 15.8 billion and if I were to take what you have already done for first half that implies somewhat reduction in cost level in second half of the year. What kind of confidence or what are the efficiency in the pipeline for us to know that you are still on the track to deliver towards that cost target? And I'll have another follow-up question.

Anders Karlsson

Thank you. Yeah, I think what I said is that we are we are coming in as expected in the quarter and we said that in the previous quarter as well that the actions we have will start to pay off later in the year. But you're right, if you take the two quarters and multiply it by 2 you end up higher than 15.8. But I'm confident that we in the second half will be able to do that. And the efficiency measures we've been talking about has been primarily continued near shoring and our work with the procurement side coming in later to the year.

Yafei Tian

Just a follow-up on the cost, I noticed that there is a bit of FT increase in the group centre over the past few quarters. Could you remind us what is that increase related to? Is that investment in technology or something else?

Anders Karlsson
It's primarily – I mean if you remember what Birgitte said in the previous quarter, we have a very high ambition within digital banking and we have formed that on group level. And in addition to that we also formed a unit that we call Customer Value Management, which is very much about using customer information to provide relevant offers on a more individualised basis. So we have been investing into new FTs on those specific areas. So it's about innovation and customer offering primarily.

Yafei Tian
Okay and a follow-up question on the interest rate sensitivity table. I know it's a theoretical calculation. It will be very helpful for us if we can have a reference level that doesn't fluctuate so much from quarter-to-quarter to put into our forecast. And also in that table, do you assume any asset side competitions or do you just assume that you are able to maintain the same margin on the asset side while rates go up?

Gregori Karamouzis
It doesn't take into account competition obviously. And I think as far as the first part of your question I think it's what you have to do on your own I'm afraid, I mean we give you the parameters and certain assumptions and you will need to use those and make your own assumptions to come up with the numbers that you need to put into your forecast.

Yafei Tian
Okay thank you.

Operator
And the next question comes from the line of Peter Kessiakoff from SEB. Please go ahead. Your line is open.

Peter Kessiakoff
Yes hi, thank you. First one, just a clarification; I'm not sure, Anders, you mentioned a number for how much you think the resolution fee will be up for 2018. Was that something that you mentioned?

Anders Karlsson
Absolutely, I assume that it will go from nine to 12.5 and our rough estimation because it's based on historical balance sheets, but it's also a function of the risk adjustment that the National Debt Office will do later in 2018. But without knowing exactly how that method already looks, it's – we expect it to increase with 450 to 500 million next year.

Peter Kessiakoff
Okay then I understand you. And then just a question relating to the agreement that you took with the Swedish National Debt Office relating to payments for Swedish institutions, just it's a big agreement, but are you able to say anything in terms of what kind of income contract like that actually brings?

Birgitte Bonnesen
No, you mean that the – no. The thing is that what we did is we landed the over-all sort of umbrella agreement and under that what we're doing now is that now we are targeting each of the institutions that sort of included in this. And so far we have been winning more or less all of the institutions that we targeted. And the end of it I think that we will probably come out with more than 90% of the volume. And this is important just filling up volume so this is sort of a scale business. This was a very important contract for us. But I won't go into any specifics on how this will impact the profitability in the payments area.

Peter Kessiakoff
Okay then just a final question from my side. In the Baltics, just looking at salary inflation which seems to be around 7%, and to what extent are you able to mitigate that or should we expect to see costs in the Baltics gradually rising given that you have such a large cost inflation there?

Birgitte Bonnesen
If you look at the way that the Baltics have delivered over time, we definitely expect them to be able to handle this salary inflation going forward.

Peter Kessiakoff
But is that done by, I mean removing FTEs or is it by mitigating a central cost moving them to the Baltic so thereby you get the average salary level down or is to what extent is that are you able to do that?

Birgitte Bonnesen
You know what there are lots of different activities, but that doesn't go only for the Baltics. That goes for the entire Swedbank Group and it goes from everything from automation to near-shoring as we talked about. But also as you transform the how should I say the distribution model there will be fewer people and this is a fact, but this is a fact for the entire group.

Peter Kessiakoff
Okay thank you.

Operator
And the next question comes from the line of the Nicholas Mcbeath from DNB. Please go ahead. Your line is open.

Nicholas Mcbeath
Thank you. Just going back to the mortgage margin once again, I appreciate your comments about the trends on the loans with the longer durations. But could you say something about the front book margin development you're seeing currently and your expectations on the front book margins developments for the second half of 2017? What kind of outlook do you see here? Do you as what could have transition that could impact those margins positively or negatively? That's my first question. Thank you.

Anders Karlsson
Okay that is a good question, but it's very difficult to answer. If you look at the front book we have said flat or stable and the back book, I will not reiterate again the one that is coming in for repricing. As far as the outlook going forward, it is a function of two things Competition and Stibor. And I don't think that I can give you a good guidance on either of those.

Nicholas Mcbeath
Okay fair enough. And then also if you could quantify what kind of margin pressure you alluded to that you're seeing in the large corporate space and how you think that this could feed into the NII given the duration of this type of a contract?

Anders Karlsson
When I talked about the margin pressure, I talked about the new lending. I did not necessarily talk about the current book. So it's about the competition to increase the lending more than anything that has to do with the back book. That is fairly stable actually.

Nicholas Mcbeath
Okay thank you. And then if you could also please update on how much of the corporate loans that are now are referenced, that now are reference rate floored at zero?

Gregori Karamouzis
Amongst large corporates, it's around 50%. In the Swedish banking business, it's around 15. And then in the Baltics it's 80%.

Nicholas Mcbeath
80% of the total book in the Baltics?

Gregori Karamouzis
Yes, of the corporate book.

Nicholas Mcbeath
Okay thank you. And my final question and in the comments by the CEO, you mentioned the efforts about to fully digitise the mortgage process. If you could give any more colour on this work here, how much cost do you expect that this will that Swedbank will incur as a function of this and when this will be completed? And then also if you could maybe comment about what kind of cost savings you're seeing as a consequence or other positive impacts?

Birgitte Bonnesen
Yes, I can give you some more colour on it. I'm not so sure I'll be willing to give you an indication of the cost. But if you look at a bank like ours, the mortgage process is by far the biggest and most important process. It's also the most costly process in a retail

bank like ours. What we've done is that we have now this is a big project that is digitalising the entire mortgage process. It will be finalised in the beginning of next year. So we're very – it's been a project that has been really successful. We run it in an agile way as one big value stream. This is the first time that we've done that with a significant process in the bank. So we have all the competences that is needed and all the competences that work from IT, from the product area, for compliance, risk etc., has worked together to digitalise this. So we take every – in every step of the development we have also the customer interface element into this. So I think that this is why we've been so successful.

Some of the deliveries have been the rollover of mortgages, it's been mortgage commitments that are completely digitalised at the moment or now we also have digitalised consumer lending process that was launched this year. And we see these are old steps and finally in the beginning of next year, everything will be completely digitalised. But you can imagine that this is something that's going to – it runs through the entire bank from back to front.

Anders Karlsson

And as far as cost guidance comes we will come back in Q3 for the full year of 2017, and we will come back in conjunction with Q4 for the expenses going forward.

Nicholas Mcbeath

Just a follow-up there, when you say fully digitalised what's more explicitly are you referring to here? I mean is it that the customer experience that's fully digitalised or like how much of the back office work and administrative work is also digitalised because I appreciate that it's probably not possible to completely remove all the need for manual signings and so on given other – that there are other measures are needed by other authorities to kind of approve this like Kronofogden and so on. Could you give – comment anymore on this?

Birgitte Bonnesen

What is within our – what we are responsible for all of that will be digitalised front to back. But then of course exactly as you're saying there are different parts of the process that we cannot digitalise because we're waiting for authorities to do that on their side.

Nicholas Mcbeath

Okay thanks.

Operator

And the next question comes from the line of Adrian Cighi from RBC. Please go ahead. Your line is open.

Adrian Cighi

Hi there. This is Adrian Cighi from RBC. Thank you for taking my questions. I'll have two questions, one on asset quality and one on capital. On asset quality, you have a provision ratio of 34% for the shipping and offshore portfolio which is actually lower than the Group figure. What gives management confident that this is the right level of coverage? And then on capital, please what is your estimate for the day one impact of the application of IFRS 9 and do you see any other headwinds impacting your capital ratio in the near term excluding the Basel IV uncertainty? Thank you.

Helo Meigas

If we start to the provisioning ratio you are correct, the provisioning ratio on shipping and offshore portfolio is lower than our average as well as then which means it's lower than our normal provisioning ratio. So normally we would rather look at provisioning ratio in the range of 55%, 50-55% or even up. But the difference is that the shipping and offshore portfolio, this is actually, this is a portfolio where clients are paying interest whereas usually in the rest of the portfolio we have defaulted clients who are basically in bankruptcy. And that is the reason why we have a kind of a lower provisioning ratio on our shipping portfolio.

Adrian Cighi

Thank you.

Anders Karlsson

Yeah, on the capital side, we have said that the best estimates we have as we speak on the IFRS 9 is a immediate impact of around 30 to 60 basis points. But as you know it's a – there are a lot of components in there that can really change that, but that's the best estimate we have right now. The other headwind we see it's small, but PayEx will add a bit headwind on the capital side, but it's really small.

Adrian Cighi

Okay thank you very much.

Operator

And the next question comes from the line of Amal Shah from Redburn. Please go ahead. Your line is open.

Amal Shah

Hi, good morning. I have two questions. Firstly on mortgage competition, so you mentioned it's still high. I just wanted to get a feeling on how you think it has changed since the start of the year. And so your thought on this would be great. And the second question is on the fixed rate mortgage book. You've said that in this quarter there is a 10 to 15 bps from the back book difference. And however in the first quarter you said there was a 15 to 20 bps difference. And what I've seen in the second quarter is that you're saying that the front book on the fixed rate book has also increased so I was just wondering how do you think about it. Thank you.

Anders Karlsson

If you look, start off with the competition and the development of the competition, it continues to be high. And but what you saw in the first quarter was that basically if you look at the market you have four big players that are trying to maintain the pricing we have and you have two smaller much more aggressive players. They still continue to be aggressive, but you have seen that it has been sort of and declining slightly if you compare Q1 to Q2. What is coming from Q3 and Q4, I have no idea. It will most likely continue. As far as the back book fixed repricing comes and we have seen dynamics in the quarter in terms of list price changes in that specific space of the yield curve.

So when I'm saying 10 to 15, I take the list price changes into account. At the end of the day what will be the outcome depends on the discounts that will be given. But being cautious there the list prices has changed and therefore we changed slightly from 10 to 15 to 20 down to 10 to 15.

Amal Shah

Okay thank you.

Operator

And the next question comes from the line of Riccardo Rovere from Mediabanca. Please go ahead. Your line is open.

Riccardo Rovere

Hi, yes good morning to everybody and thanks for taking my question. A couple of questions if I may. The first one is on capital return. You keep reiterating there is no excess capital and this is a kind of like motif that we have been hearing for so many quarters that I don't even remember how many they are. Now some of your competitors have starting being say more active on this front, Danske more recently, DNB maybe Handelsbanken. Now what prevents you from been more active on one side, but that may be stating clearly on the other side that if regulation gets tougher all of us are then you might eventually revise a more active capital return instead of waiting for an enemy Basel IV that never comes. This is my question, my first question.

The second question I have is on the guidance that you've just provided on IFRS9 is the 30 to 60 basis points guidance fully phased or phased-in in say five or what six years making it relevant at first time application. And the last question I have is for Helo if we strip out the oil and gas component with the current level of rate, you see the level of provisions that you have reported in the first half as kind of a sustainable going forward if rates do not change? Thanks.

Anders Karlsson

Thank you, Ricardo. Now to start off with your capital question and just to remind you that we adjusted our dividend policy. It is at 75%. It is adjusted to the fact that we have seen subdued demand in the loan space. Then whether it's, but we have said that clearly we are not stacking up capital for the sake of stacking up capital, but we are handling it through a fairly aggressive dividend policy. As far as the enemy, as you call it the Basel IV comes, we might have slightly different views on whether it will come or not. So I will not comment on that. When it comes to Danske and DNB, they are working in other jurisdictions so that I leave to them to handle. Other than that, I don't think I can comment on it. As far as IFRS9 comes it is an immediate impact.

Riccardo Rovere

So immediate impact means not phased-in, but what this mean?

Gregori Karamouzis

It is a one-off impact when we'll move into the IFRS9 accounting principles. And then thereafter we have a new base where provisions will move up or down depending on how the macro or the loan book develops.

Riccardo Rovere
Okay.

Helo Meigas
I've been answering your questions about the credit quality and credit impairments in our total home market. We have a continued goods credit quality and the provisioning rate is of course reflecting what we perceive to be the risk in the underlying portfolio. What you need to keep in mind is that we have had a very benign environment for a long period of time, which means we have a very small level of impaired loans. So each individual impairment will be very visible in the provisioning level so that's why saying that you would continue to see kind of plus minus zero credit impairments, I think it's – it would be a kind of unfair to expect this type of level. So things pop-up because we do take risk and that's what we have paid for so that's why you might see some changes quarter-for-quarter as we kind of go forward in the cycle.

Riccardo Rovere
All right okay, thanks, thank you very much.

Operator
And our next question comes from the line of Jacob Kruse from Autonomous. Please go ahead. Your line is open.

Jacob Kruse
Hi, thank you. I just wanted to follow-up on the NSFR question from earlier. So you lowered your guidance from 100 million to 50 million per percentage point decline. Wouldn't that if I understand that correctly that's because the funding cost is lower, so wouldn't that imply that you have a benefit on the funding cost side that assuming the guidance that you're talking about is correct that you would also get an offsetting benefit to the rolling funding if you do not move your NSFR or are these different dynamics? Thank you.

Gregori Karamouzis
Hi Jacob, it's Gregori here. I mean the funding it's correct. Funding spreads or cost has come down that's why there is a smaller per percentage unit sensitivity. And the funding cost is moving up and down and that is what we tried to price into our internal pricing with price deals towards the customer. So if each the margins that you should be following rather than funding cost per se. So our comments are on funding cost is baked in when we talk about margin development in corporate or private lending.

Jacob Kruse
Okay that's clear. Thank you very much.

Operator
And the next question comes from the line of Alice Timperley from Morgan Stanley. Please go ahead. Your line is open.

Alice Timperley
Hi. It's Alice Timperley from Morgan Stanley. Thanks very much for taking my question. And could you perhaps give an update on your thinking around PSD2 and from the perspective of the APIs that you have in place and the ambitions that you have around the technology that you want to implement in the longer term and also the cost associated with that. Also when we listened to the Bank of America call yesterday, they commented that on those sort of mobile deposit taking front, they've been able to do this – also they expect this could be done at one-tenth of the cost which is versus that over the counter. You guys could you give us any detail on how you think about the digital transformation from a cost perspective going forward? Thank you.

Birgitte Bonnesen
Thank you, really relevant question. I think if I can start off with the latter part of your question. We have a plan for the transformation of the distribution as such. I won't be able to give you any numbers because we don't actually guide on that. But we have a very clear plan on assumptions what we think will happen and how that will affect the traffic in the mobile, the internet bank, the telephone bank and in the physical space. When you talk about the physical, we'll see a transformation. This is in our plan of what are actually the things that we do in the physical space. What is going to be the size of the branches? What is the activities that's going to happen in the branches?

And when I talk earlier on the call about we see this corporate banking activity, this is one of the results of the way that we change the working methods in the physical space. There will be a lot happening in this space. Also this quarter we came out with a new version of the internet bank and the mobile bank. So we're continuously every three weeks, we're actually delivering a new feature or changing of the touch and feel in the digital space. That will also change the structure of the cost of course over time, but I will not talk about this. As to the PSD 2, we have a number of initiatives. What I talked about initially with the Mina Tjänster that is part of that initiative too, same thing with the acquisition of PayEx.

It all boils down to the strategy and the wanted position that we strive to maintain the interface with the customer and then we collaborate with others in order to enable us to stay strong in the interface. So when we also finalise the sandbox setup, and we are almost ready with the APIs in preparation for PSD 2. So we're moving steadily slowly, but surely in the right direction. We have initiatives both on robotics and AI, and we're setting up a new structure for all of this. But I think that I will come back on that in the third quarter and well probably third quarter so I can be more concrete.

Alice Timperley
Thank you very much.

Operator
And we do have a follow-up question from Andreas Håkansson from Exane BNP Paribas. Please go ahead. Your line is open.

Andreas Håkansson
Yes, hi thank you. Just a follow-up on the resolution fees. You say that the increase is about 450-500 in 2018. Could you just confirm that you were then in 2019 expect roughly the same drop again from 2018? And then in 2020, we should see roughly 5-600 hundred million additional drop from the 2019 level?

Anders Karlsson
Yes Andreas, the answer is yes with the disclaimer that it is dependent on the balance sheet composition as you know. And that could change over time, but other than that that is a good assumption to make.

Andreas Håkansson
Okay thank you.

Operator
And as there are no further questions registered, I will hand the call back to the speakers. Please go ahead.

Gregori Karamouzis
Thank you and thanks everyone for taking part at this call, and wish you a good summer, and probably meet some of you on the road over the next few days. Thank you.