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PRESENTATION

Operator

Good day, and welcome to the Banorte hosted Fourth Quarter 2018 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ursula Wilhelm. Please go ahead.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Good morning to all who are joining us in this call. Welcome to Grupo Financiero Banorte's Fourth Quarter and Full Year 2018 Earnings Call.

Today's presentation may include forward-looking statements that are subject to risks and uncertainties, which may cause actual results to differ materially. We ask you to take this into consideration.

Marcos Ramirez, Chief Executive Officer, will provide an overview of the quarter. Thank you, and I leave you to Marcos.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Ursula. Good morning everybody. First of all, I want to wish you a very successful year. Thanks for listening to the conference call. We have a lot to tell you in this hour. I will review with you our results; and Rafael Arana will explain some capital adjustments that has strengthened our balance sheet and our guidance for 2019. We are truly pleased with the results that the group achieved in 2018. And also in the fourth quarter, usually our stronger quarter in terms of volume and results and this time was no exception. It was remarkable.

The group achieved several milestones during the year: first, the acquisition and integration process with Interacciones was completed, already achieving positive traction on our results. Second, the annuities company closed the acquisition of two annuities portfolios for an aggregate amount of 19 billion pesos. Third, we completed a relevant sale and lease back transaction. Fourth, we continued to make progress to achieve our 20/20 goals with the right set of incentives. And finally, but not least important, results were along the range where we compromised to you for 2018, thanks to the collaboration and positive evolution across our different businesses.

On the macro front there were also positive developments. On the one hand, Mexico held the largest electoral process in history by number of positions to be elected. It ran smoothly and peacefully despite an aggressive campaign period. On the other hand, after almost a year of negotiations and controversy, Mexico, Canada and the United States reached an agreement on the commercial front to produce the USMCA which will substitute NAFTA, vanishing a cloud that hanged over the future of the Mexican manufacturing and exports sector.



For Grupo Financiero Banorte, 2018 was an exceptional year. Let me refer to the fourth quarter first, which you can find on

Return on recurring equity was 20.1%, higher in 41 basis points. While reported equity was 23.8%.

The NIM on slide 4, declined 30 basis points to 5.4%. It's entirely explained by the full impact of the various acquisitions of assets in the formula to calculate the NIM as well as the strong growth posted in the corporate and commercial books.

Trading income posted remarkable results mainly on transactions with customers and completely offsetting the volatility that affected Mexican assets post government decision to cancel the airport project. In this regard, trading income was 1.2 billion pesos, and it includes 700 million in revenues related to several derivative transactions with clients.

On Slide 5, expenses. They grew 6%. Some administrative expenses were impacted by the fx depreciation. Personnel expenses include a portion of year-end pay and also 150m pesos in severance payments related to the integration. Advisory fees include 300m in legal and financial advisory fees related also to the transaction.

The loan book on slide 6, was up 3%, supported by solid growth of 7% in the corporate and commercial books.

Credit quality in the quarter evolved positively. The NPL ratio declined 13 basis points to 1.7% on improvements in NPL formation all across the different portfolios, which also led to a 5% decline in delinquencies.

Cost of Risk closed at 2%, explained as follows: First the quarter saw lower provision requirements on better NPL formation. Second, the ratio was favorably impacted by the full incorporation of the acquired assets, as per the calculations of the cost of risk formula.

Now let me mention the main highlights of the full year results, which you can find on slide 8. I want to stress again that 2018 was a strong year for GFNorte. The results presented to you demonstrate exceptional attributes and great quality including, high recurrence, pricing quality and growth in client volumes:

Recurring Net Income was 30.3 billion pesos, up 27% annually. Reported Net Income reached 31.9 billion.

Recurring Earnings per Share reached 10.51 pesos, higher by 22% than the prior year. Reported Earnings per Share were 11.08 pesos.

Return on Recurring Equity was 19.3%, expanding a remarkably high 230 basis points over the 17% reported the prior year. Return on Reported Equity was 20.3%.

Business growth was solid, with overall loan growth at 26% including the acquisition, deposits increased 17%, while insurance premium grew at a 14% rate.

Subsidiaries results on slide 10 were strong also, among the most relevant was the bank with recurring profit growing at 26% and Insurance at 24%. The Afore saw its earnings decline by 2% on market volatility, while the Annuities company's profits declined 7% on the impact of the acquisitions. But excluding extraordinary elements, its recurring net income increased 35%.

Annual asset quality metrics also improved with the NPL ratio ending at 1.7%, 30 basis points better than the prior year, and reserve coverage strengthened to reach 142%.

Regarding the Interacciones integration, we estimate that the operation generated around 2 billion pesos in net profits during the almost six months that they were booked in Banorte. The accretion achieved on the transaction for 2018 was 3.7%.

The cross-sell ratio in December reached 1.97 products per customer, also better than the 1.89 ratio of the prior year.

I'm delighted to communicate to you that full year 2018 results are in line or better with the numbers that we committed to achieve at this same time last year.

Results speak for themselves. You can see the details on the conference call deck.

Banorte remains in a privileged position to withstand the changing environment and grow successfully. The financial group enjoys healthy finances, a strong capital position, capital generation power, a diverse business architecture and a solid franchise of loyal customers. Investments made in state of the art technology and distribution, will continue to support efficiency gains and profitable growth. And these, along with improving customer service, are helping us to expand the share of wallet with our customers.

Now I want to move to our outlook for 2019, which seems less challenging than what the market seems to expect. Our GDP estimate stands at 1.8% in line with consensus, inflation should come down to 4%. Regarding interest rates, we expect the Central Bank to remain on hold all through the year. We also expect salaries to grow above inflation, despite downward revisions on salaries for some segments of the public sector employee base.

Noise and volatility could still be present as we and the market adapt to the new government administration. But still, we are positive overall. We see a genuine willingness on the new government to reduce the informal economy and increase financial and banking penetration. At Banorte we are supporting the government in the disbursement of the social programs to the young and the elderly with debit and electronic products that will go directly to the program beneficiaries. For us it represents an opportunity to get access and gain knowledge and data on these segments and their behavior to eventually put in place efforts to strengthen the banking relationship with them.

The banking system is working in coordination with the government and the financial authorities, as you saw in the joint press conference of a few weeks ago where some new initiatives were announced.

Regarding this announcement, let me tell you that we are optimistic about the central bank and the private bank's initiative to build this new digital payment infrastructure for the country, which will not compete but will complement the existing SPEI and cards platform. Banorte is participating actively in this effort, as we believe that over the medium term this platform will allow us to tap the underserved low income and informal market in Mexico in a very efficient way.

CoDi, as it is called, is a push and pull mechanism that will be inter-functional in the market and will bring very high security standards. It will be operational 24/7 and will not [bear] cost for users. However, payments will be made through the mobile either person to person, person to business or business to business.

A bank account in the digital payment transaction is required, and this is the opportunity for us. This will allow Banorte to enter to low-income segment and informal market at a very low operational costs.

On the potential reduction on fees, let me remind you that the Central Bank has the authority over fees. And banks, we need to get authorization from the central bank anytime that we want to change a fee or introduce a new fee. It is not an easy process. While the fee issue is still open we believe that there will be a reasonable outcome beneficial to customers, and beneficial to Mexico as it will also secure future investment in banking infrastructure and technology.

With this, I conclude my remarks, and now I will turn the microphone to Rafael Arana, who will give you some details about the extraordinary transaction and will also comment on our expected results for the year 2019. Rafa, please walk us.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Thank you Marcos. Good morning everyone. I want to go over several important topics with you. First, an update on the dividend policy, second an update on the legacy assets from the homebuilders, third a few comments on the capital adequacy ratio of the bank, and finally I want to present to you our guidance for 2019.

I want to inform you that in our last meeting, the Board of Directors approved to increase the maximum dividend payout ratio from the current 40% to 50%. The next step in the process is to take the new policy for approval at the next General Shareholders' Meeting which will take place at the end of April.

We anticipate a positive resolution on this proposal at the AGM and therefore we expect to present to the Board of Directors and Shareholders the request for approval to pay the 2018 profits at a payout ratio of 50%. We will also put to their consideration the extraordinary net profit of 1.6 billion pesos to be included in the 2018 dividends to be approved and distributed later in the year.

On the homebuilders legacy assets, I can tell you that we have been actively managing them. Throughout this time we have been putting in order the legal aspects of the assets that Banorte received from the restructurings, while at the same time we have been adjusting downwards their value according to market prices in some cases and fair value in other cases. We also have been following developments in the low income housing market. We believe that the opportunities in this market are limited and are already satisfied by the existing players in the industry. We also continue to see a limited participation from the government as a subsidized grantor to this market. A lot have been changing and a lot have been remained fairly similar in size. Therefore taking these thoughts into consideration as well as the authorization of the CNBV we made the decision to write-down the value of these assets in the balance sheet to reflect a recovery value aligned to the medium term prospects in the industry.

Let me give you the details:

During the fourth quarter, we made a reclassification of 3.4 billion pesos in losses from the account 'valuation result from securities held for sale' to the 'retained earnings' account, based on the regulatory authorization by the CNBV dated October 2018 described in our earnings report. This reclassification had zero impact on equity.

The valuation loss is related to the mark-to-market valuation of homebuilders' shares received at the closing of the restructuring agreement. You will recall that we had been valuing these shares at market value.

Regarding the investment projects, we changed the accounting methodology to value these assets to better reflect market conditions.

The new methodology used is based on the Present Value of Future Flows. The initial impact is a loss of 4.3 billion pesos. Since the loss is a consequence of the change in accounting policy, it was registered in retained earnings as per NIF B-1.

Excluding the write-down and the extraordinary net profit from the capital base and earnings, the normalized Return on Equity in the quarter was 19.83% versus the 23.8% reported and the normalized ROE for the full year was 19.17% versus the 20.3% reported. These ratios are still quite strong and improving. Let me assure you that the normalized return on equity is the indicator that we will be using to achieve our 20% ROE target in 2020, this already at this point seems it will be surpassed.

Moving on to slide 10, and shifting subject to the capital ratios of the bank. I am pleased to report to you that both the Capital Adequacy Ratio and CET1 increased 60 basis points during the quarter. The capital of the bank was not impacted by write-downs just described.

However, it benefited from the extraordinary profit registered in the quarter, in addition to the active capital management that we carry out routinely.

In this context, let me remind you that our internal floor regarding the CET1 ratio is 12%. While our level of comfort is above this threshold.

When the GFI deal was announced we advised that the CET1 ratio would go down to 11.4% and by yearend would climb to 12.1%. We beat this commitment by 65 basis points.

Now moving to the final topic on slide 11, let me tell you where we see the results for this year. As Marcos mentioned earlier, we expect a

positive performance this year. The group has a strong balance sheet and coupled with the 26% growth in the loan book, we anticipate a good growth story going forward.

Therefore, the goal metrics that we commit to achieve in 2019 are as follows:

Loan growth between 7% to 9%, with a breakdown as follows:

Corporate and commercial at 10%;

the government book flat to negative upon the demand dynamic in the government financing market;

mortgage and auto growing at 12%,

while payroll growing at 7% and credit cards at 12%.

Total customer deposits growth at 12%

The net interest margin should expand around 10 to 15 basis points

Growth in expenses between 7 and 9%. In this number we are including 600 million pesos in additional expenses related to running the Interacciones operation for 12 months - remember that in 2018 we only booked expenses for 6 months-, plus around 350m pesos in rents related to the sale and lease back contract.

The cost to income ratio will decline to a level of 37.5% and 38.5%

The cost of risk will be in a range between 2.0% and 2.3%

The tax rate will remain similar to last year, between 27% and 29%

The expected net income range will be between 35.8 billion and 36.8 billion

ROE should range between 19.8% and 20.3%.

This scenario incorporates the macro assumptions that Marcos mentioned to you earlier.

With this I conclude my comments and now I open the call to questions. Thank you for listening.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from Mario Pierry with Bank of America.

Mario Lucio Pierry BofA Merrill Lynch, Research Division - MD

Hello. Can you hear me?

José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member

Yes, Mario.



Mario Lucio Pierry BofA Merrill Lynch, Research Division - MD

Okay, sorry. Let me ask you a couple of questions then. Thank you for the presentation, very detailed. Rafa, if you can go through the loan growth expectations, again, by segment? And how does that tie in with your comments that you have on Page 6 that you made a strategic deceleration in unsecured consumer loans this quarter? So just give us those numbers, again, for your expectations for loan growth in '19? And also, I wanted to get a little bit more clarity on what Marcos mentioned on fee income and changes in regulation. Okay, it's clear to me central bank has the authority of the fees, but it's not clear to me that you do expect some changes in fees in '19, and if that is already reflected on your estimates.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance

Yes, Mario, first, let me go to the loan growth. We are very confident to continue have a very reasonable growth in the consumer book. As I mentioned to you, the corporate and commercial, we are quite confident that we can grow this book around 10%. The government book, when we say that is going to be flat to negative is because we already have a sizable portion of that market. And by keeping just the size of the book that we have and funding those assets at a much better funding cost, we are getting a much better result than go aggressive into the market to grow in that part. The mortgage and the auto loans will grow at 12%. It's a reduction from the past year, but still a very strong growth. And payroll is growing at 7%, now that we see more clarity on the government entities and when compared to last year that we were very cautious on the payroll loans. Credit cards will grow at a strong 12%. We'll continue to gain market share on a yearly basis. So we see this as a very solid loan growth. As you know, we basically grow with our own client base. So that's why we are also very confident in the cost of risk and the NPLs. And by growing the demand deposits at around 12%, we will continue to see a much better funding cost to fund those assets.

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member

Mario, talking about the change in regulation, sorry, we don't have the crystal ball, but Gabriel Casillas is going to give us an idea of this, please.

Gabriel Casillas Olvera Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis

Thank you, Marcos. Mario, just a quick comment here on these regulatory issues. Two things. I mean, you're right, the central bank continues to have, I mean, this is the one in charge of regulating fees and commissions. But let me tell you something. When we saw this initiative that was announced, remember that President López Obrador said that he was not -- I mean, he was not part of these core policies. And I think that one of the good signs and good signals that we saw, it was 2 weeks ago, remember this program to boost the financial system, that actually you covered quite well, he didn't even mention this in his speech or in any of the measures that he announced. So of course, we're working closely with the government to see how this can evolve. But very important here, President López Obrador has his core policies. He wants to pursue these policies that are written in his book. And if he tries to pursue others' policies, he's not going to be able to fulfill the -- what he promised. So these will be my comments, Mario.

Mario Lucio Pierry BofA Merrill Lynch, Research Division - MD

Okay. Let me go back then just quickly on the loan book, Rafa. So it seems to me that the mix is not going to change much going forward, right? Your corporate and your consumer book should be growing around 10%. And then you're guiding for net interest margins to go up 10 to 15 basis points. But if I look your net interest margin, in the fourth quarter alone was 5.4%. And in the full year, it's 5.6%. So your guidance implies an increase from current levels of about 30 basis points. Where's that improvement coming from? Is it primarily still the synergies from the better funding at Interacciones?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance

Yes, let me remind you by the guidance that we gave the market, when we announced the integration of Interacciones that we guide the market that there was a potential reduction in the net interest margin for the year after the integration of minus 10 to 10 basis points at best. We beat that by growing 16 basis points that point. So we have been actively managing the funding costs. The funding cost now is 60 basis points below what when we acquired the assets. As you know, we got rid of MXN 70 billion of funding that was quite expensive, And we still see at least 14 basis points more in this basic funding cost. So that's part of what you see the margin expanding. Also, remember that the effect of the latest hike in the interest rate hit us hard on November and December, and that will soften through the

year and will improve the -- also the margin base upon on those 2 things. So we are quite confident on this on the growth in the margin by the mix, by the funding costs. And also remember that every single day that goes, we fund the assets from Interacciones at a much better funding cost. And that is really proving to be a very stable source of growth, not just in the net income but also in the margin side. You can see that the margin on a yearly basis grew 16% compared to the usual 14% that we have on a year-to-year basis in the past.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

And Mario, if I may just add, you have to take into consideration that the base to calculate the margin has changed because we are now fully incorporating the assets that we acquired both from Interacciones and even from the pension company, no? Those assets also increase the base. And the decline in the margin is entirely explained by that mathematical effect of the calculation. So you will now have to take this base as a new base. And therefore, on a sequential basis, the 5.4% number becomes your number to track the expansion in the margin going forward.

Mario Lucio Pierry *BofA Merrill Lynch, Research Division - MD*

Right, now -- but that was my point, Ursula. So your guidance for the year then is about 5.7%, right, considering that you delivered 5.6%, and you're starting from a base of 5.4%. So it means like you're expecting a 30 basis points improvement in margins from current levels.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

The quarterly margin does not necessarily is going to renew the annual margin for the following year because there is a lot of -- if you -- that is why we will give you always a trend line on a quarterly basis, and you can see the volatility. I think in the end, it's more of an average. But, yes.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes, no, but I think it's -- I think, we should be sticking to a margin as you mentioned to reach the 5.75%, I think, is a very reasonable number.

Operator

And we'll take our next question from Jason Mollin with Scotiabank.

Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services*

I would like to ask 2 questions. The first is on the outlook for changes in the financial sector. You've referred to some of them. But how do you see the new government participating in the financial or banking sector, for instance, the outlook we've discussed a little for fee regulation, pension fund reform? And do you see possible intervention in the banking sector on the interest rate cap front? And my second question is on the negative hit to book value of about MXN 7 billion that was not reflected in income. Are there impacts on future cash flows from the assets that were written down? Or was this just a valuation related to past accounting? And what other adjustments do you expect in the future? I've ask this in the past. Should we expect hits, for instance, from IFRS 9 or any other issues that you think would mark-to-market -- would hit the mark-to-market of your book value?

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Jason. The first one, we'll go to Casillas and the second one to Rafa. Casillas, please.

Gabriel Casillas Olvera *Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis*

Thank you, Marcos. Hi, Jason. As I mentioned quickly about the fees and commission, remember that MORENA, the actual party, the ruling party, it's not a party, it's a movement. So it has people from all sort of ideological backgrounds. So you have Poncho Romo who leads the office of the presidency, who is a full capitalist, and then you have people that are really on the extreme left. So these -- we're going to hear a lot of noise from legislators because of this. But this doesn't mean that the President is going to pursue those policies. So I think this is very important. And with this, I go to the second part about the changes in the pension fund regulation and the ones that you mentioned. Made this announcement 2 weeks ago about this program to boost the financial system. I think it was very important that the President did not mention at all the fees and commission issue. But on the other hand, remember that the President was there with the governor of the central bank, with the Chairman of the CNBV and, I mean, the people related to that. One of the things that they mentioned or one of the policies that they mentioned there was to change the pension fund regulation. But in terms of 2 sites -- of 3,

sorry, number one, want to have a more flexible investment regime; second, they wanted to improve or to boost the securities lending market that actually is, as you know, it's not very active unfortunately; and three, to have a more flexible ways to save on a voluntary basis because, as you know, we have the compulsory system, but in the voluntary savings part, it was not very easy to save and more importantly it was not easy to actually withdraw the money. So now it will be easier to do that. So I think, all these things that actually encompass the new initiative to reform the pension fund system are actually initiatives that actually we have been pursuing in the past few years with CONSAR. And they were there in the desk, and they were not able to put them forward, so they put them together. And now actually, we are very happy with these initiatives. So having said that, in terms of the question on the intervention on interest rate caps, remember, the central bank continues to be the entity in charge of that, and they are not ruled by one person. They have 5 board members or 5 members of the board. And even though, now they will have 2 different board members, starting with February 7 meeting. Actually, nobody has talked about doing anything like radical in that sense. So, so far, we are not expecting these changes in regulation with negative impact. On the contrary, we're expecting the changes to have a positive impact, not really in the short run, but maybe in the medium term. Actually, we're positive and quite optimistic on these issues, to be completely honest, Jason.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Jason, on the second one, and thank you for the question, because it allows to explain what's really a reduction in the retained earnings, the MXN 4.3 billion, that as we mentioned was related to the investment projects that we have and the other is merely valuation, the MXN 2.7 billion for a total of MXN 7 billion. And that valuation goes on a monthly basis, moves up and down. I think that this is the range maybe in 2 or 3 months could be a positive number as it has been in the past. But MXN 4.3 billion is what we hit on retained earnings and MXN 2.7 billion is pure valuation. On what you mentioned about the IFRS, we honestly don't expect any -- we already had expected loss methodology. We have been adjusting everything to align ourselves and the CNBV to the IFRS. So this has been a continuous evolution from the banking system to the IFRS. So we don't see any bad news coming from that front at this point in time, and we don't anticipate any more hits on the retained earnings related anything about the homebuilders or anything related to the loan book or anything like that. I think it was already the right time. We have been talking a lot with the CNBV by doing this adjustment in retained earnings, and it's basically because as we mentioned in the past, every single year, we were reducing the value of those assets with MXN 1.3 billion. So we finally in just one movement completely balance out that instead of keep on reducing the value of the assets by MXN 1.3 billion per year. So that hit will not come again into the net income anymore. So it was a very detailed and long process with the CNBV, but it was based upon that we were always valuing the assets to the market, and we decided in alignment with them to finally get rid of that part of the balance sheet that was causing a lot of concern to our investors.

Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services*

I think -- I mean, it's interesting because when you look at the book value over the last 3 years, we've had multiple, I guess, hits or write-downs if you want to call it, for different reasons, sometimes -- maybe it was the goodwill that we had from the investment in the U.S. or this revaluation of these assets. But it has been -- I mean, I have to go through these numbers with you to make sure that they're material with the merger -- they are correctly done with the merger with Interacciones and the share issuance, et cetera. But it has been part of the book value evolution, has been a negative hit, and it's material between 3%, 4%, 5% of average equity. So it's just something that I think we want to consider because this ROE is looking fantastic. And my calculation is that if you exclude this MXN 7 billion, the recurring ROE would be 40 basis points lower. So it's below the target 20%, but you're right there. It's pretty impressive. So I just want to -- I want to make sure that we're not going to get these kind of hits because they're material relative -- do you consider them material relative to the size of the bank, when the book value gets hit by 4%?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

No, I think, we are not considering like our practice to really hit the book value. If you look at the numbers for this year, you'll see an increase in the capital value of around 18%. So I think that really shows the positive generation of capital of the bank. So 18% after all the adjustments is quite solid. No, we don't anticipate any more hits about like this. I mean, a lot has to do with the integrations with the acquisitions, as you mentioned, and the homebuilders piece, that has been a very painful process, not just for us, but for the market. But with this, we finally cleaned this part of the balance sheet. And instead of keep reducing MXN 1.3 billion per year on the net income, we finally reached an agreement with the CNBV. And under the regulation, we finally apply that to retained earnings instead of waiting 3 more years to clean up that part of the book. No, anything in the capital for us is quite serious. We can define material and nonmaterial. I

think it's part of the shareholders' equity. It's part of the investment of our shareholders, and we take that in deep consideration when we do anything like this. But overall, I think this is positive in a way that we clean the balance sheet, and we strength the balance sheet. The balance sheet is completely clean. And the capital base continue to grow nicely after all these adjustments, 18% in the year is not easy to grow.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

And maybe, Jason, you can -- you're very welcome to review these numbers with us and to get rid of these misperceptions.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes, no, no. Happy, and thank you for the question, Jason, because I think it allow us to really explain that in detail why we are doing this, and why we did this. And it was always under the full supervision and agreement of the regulators.

Jason Barrett Mollin *Scotiabank Global Banking and Markets, Research Division - MD of LatAm Financial Services*

And the operating trends look very good.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Thank you.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Thank you, Jason.

Operator

And we'll take our next question from [Carlos Rivera] with Barclays.

Unidentified Analyst

My first question is regarding the outlook for asset quality. And I'm looking at the guidance, the cost of risk, and it looks below the level that we saw in 2018. So I think you're pretty optimistic there. I know there are some -- there was a onetime effect due to our corporate. In 2019, it will not be there, next year. And also the cost of risk of Interacciones is lower. But if we exclude those effects, are we getting to a cost of risk that is still similar to this year? Is it lower? And just wanting to know the reason for this, given the potential deceleration of the economy and probably also linking to Marcos' comment that things are better than the market is expressing. That will be my first question. My second question, just going back a little bit to the fee income, just in terms of the time line, [Santo Montel] was mentioning that potential resolution this spring. Is it something you see coming soon? And you had preliminary shared a few figures of an impact, I remember probably MXN 2 billion, MXN 2.5 billion. Have you updated this estimate? Or can you share with us what is implied in your net income guidance for noninterest income growth?

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Okay. Carlos, thank you for the questions. On the time line, we really don't have a much information to tell you in detail.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Nobody has it.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Nobody has it. So we have nothing to comment. And on the asset quality outlook, yes, especially, we are looking at better performance in the books of the consumer portfolios. If you see the trends that we had in 2018, we have higher-than-normal NPL formation in the cards and payroll books, which through the year, we managed reason why these books grew at a lower rate than in the past. And therefore, we expect that all of the measures that we took last year will be evident in the performance of the books this year, which is the case already in the more operational numbers that we follow on a weekly and monthly basis. So that is the reason for the outlook for -- on asset quality.

Gabriel Casillas Olvera *Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis*

And Carlos, this is Gabriel Casillas. Just wanted to complement a couple of comments about what we're thinking in 2019, in terms of economic growth. I mean, as you know, for more than a year, we have been forecasting a growth rate of 1.8%, taking into account that the first year of government, usually GDP faces a deceleration because of the change of government, mainly. So having said this, are the 2 pillars of growth that we're seeing this year is, number one, private consumption. This is mainly because of real wage gains. Inflation in our view will continue to be quite controlled. Actually, we're forecasting inflation to end this year at 3.5%. One of the main things about inflation will be the pricing -- the gasoline pricing formula. So in this context, we tend to think that gasoline prices will increase around 3% throughout the year. And as you know, in the CPI, gasoline prices now weight around 7.5%. So it's a big weight for something that important. So that's on the one hand. And the other one, it's formal employment. We continue to believe that formal employment will continue to grow at a higher pace than GDP. I mean, honestly, one of the things is that the labor market reform that in our view was responsible -- was the main responsible of this hasn't been tackled down or anything hasn't been mentioned at all. So in this context, we are quite optimistic on private consumption. And the other pillar of growth in our view will be exports. As you know, now that the trade negotiations with the U.S. and Canada have vanished, even though we will continue to hear some noise because we still need the legislative approvals. For a lot of businessmen in the export-related industry, this is a bygone, and they have already continued to resume their investments. So -- and with the U.S. economy, despite the government shutdown and the possibility that we -- that it could face a deceleration by the end of this year or the beginning of next one, is still maybe U.S. economy will continue to grow around 2.5%, 2.6% this year. And so in this context, we continue to believe that exports will be another pillar of growth. And a final comment, if you take a look, but I'm sure you know it by heart, credit cycle in Mexico, not for Banorte but for the whole banking industry, you can see that it seems that we finished the credit cycle. If you take a look to credit growth and NPLs, and it seems that we're about to start a new credit cycle. So I think, there are a lot of positive signs in this context in terms of the economy this year in Mexico.

Unidentified Analyst

Okay. Just -- I have a question regarding the implied guidance for noninterest income growth. Is that something you can share with us?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Could you repeat it, please, Carlos? Because there was some noise on the line.

Unidentified Analyst

Sure. So I would like to know, if it's possible, what is the assumption that you have for noninterest income growth that -- it's implied in the guidance of MXN 35.8 billion to MXN 36.8 billion?

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Yes. For the trading income, remember that we usually budget around MXN 700 million to MXN 800 million per quarter. So this would be the same number that we are expecting for 2019. And for fees...

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

12% growth. Now the fees will grow -- continue to grow at 12%. I think the more we move to alternate channels and things, and so fees continue to be quite strong. And let me go back to one question that Mario did at the beginning, if there was some buffer on the budget for the fees, it's not just for the fees, I mean, we also see what we call tax forces that we have to balance out if something's happened on the budget. So we are quite confident that those 12% will stay on the book. So we don't see any issues why it shouldn't be like that. A lot of evolution has been happening in the fee side on the Mexican banking system. If you compare ourselves to the markets that we serve in Latin America, and in Europe, and in the U.S., we are quite below those fees numbers, when you benchmark the banking system -- Mexican banking system with the other banking systems.

Operator

And we'll take our next question from Philip Finch with UBS.

Philip Finch UBS Investment Bank, Research Division - MD, Global Banks Strategist and Latam Banks Analyst

I guess, first, just congratulations on reaching your MXN 0.20 ROE target 2 years early, it's pretty impressive. So congratulations. The first question is related to the ROE target. You've been consistently talking about this the last 3, 4 years. I guess, now that we're sort of reaching then, so the suggestion from your 2019 guidance, what aspirations do you now have going forward? So should we assume this is a 20% level that is sustainable? Or is there upside? Or what should we be thinking here? And the second question is regarding the relationship between interest rates and margins going forward. Obviously, interest rate expectations seem to have come down. Rates are no longer expected to go up this year as you mentioned. Inflation seems to be under control. So the question is, if and when policy rates start to come down, what impact could this have on your margins going forward?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance

Thank you very much. As we mentioned -- and thank you for congratulating the group on the numbers. On a recurrent basis, we still have some space to reach our 20% recurrent, but we -- as you mentioned, we are quite close, and we are very confident that we will reach this by this year on recurrent basis. Going forward, what we see is a complete evolution of what we have been investing in the past in the technology side to make transactions easier and easier for our clients in order to keep reducing the cost to serve them, and really allow them to have a very emotional, and a very seamless experience among the channels, so that will allow us to keep on penetrating the value of our clients, and that will continue to guide us to much better numbers on the net income. As we mentioned, we have a very well-developed financial group in every part of the businesses. So we don't anticipate really any need to keep on growing the efficiency of the group by getting a lot of new entrants or acquisitions to the bank, but we continue to see evolution on the cost side, we continue to see evolution on the cross acceleration and on the value per clients, and that will make sustainable the rate of growth for the returns for the shareholders. If we -- I would not like to give you any numbers now that if we will jump above the 20%, like a big jump or anything like this, but you will see a continuous evolution what a very efficient bank, very centered on the client as we have been investing heavily in making our client the king in how do we design the processes and how we design the elements of the bank. So you will continue to see a very efficient bank going forward and very profitable for our shareholders. I'm not confident to giving you any numbers concerning the return on equity, but it will be above what it is today, yes. And on the interest margins that you mentioned, remember that there has been a very fierce competition in the Mexican market regarding the consumer books. So when you see the mortgage book, the car loans book, the margins are getting thin, but also the expected loss and the NPLs are very low for us, less than 1%. So if you see the trend in the interest rates start to go down, the consumer book immediately will benefit on that. And on the liability side, 35% of our liabilities have a cost on our time deposit base, and time deposits has been the anchor, what we have been funding the Interacciones integration. So we could be less aggressive on that part, even not growing at the rates that we have been growing above the 20%, and that will allow us also to reduce the cost of funds. When you see that risk-adjusted margin for the group, that is sitting at 4.47, I think that's the number that we should be looking at, and that number should hike maybe to 4.60 because of the managing of the risk and the funding cost. So yes, we will continue to see evolution on the margin side because of the mix and because of the funding, and we still have a lot of room to grow -- to reform the assets of Interacciones. We're already at 60 basis points less, better than we anticipated when we guided to you, but we still see a lot of room to improve those funding costs on that part. So yes, the margin, if we also see a reduction in the margin, honestly, for us, is very positive for the consumer. We will be having a reduction on the corporate and commercial and government book, but that will be more than compensated by the reduction in the cost of funds.

Gabriel Casillas Olvera Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis

Philip, this is Gabriel Casillas. I just want to add, on the industry...

José Marcos Ramírez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member

Thank you, Philip.

Gabriel Casillas Olvera Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis

Philip, just want to -- this is Gabriel. Just want to complement a little bit on the interest rate expectations. Let me tell you something, if you believe that the economy could decelerate in the U.S., and of course if that happens, it will happen in Mexico as well, you're thinking that the U.S. Fed might not continue to hike, and maybe it will start, eventually, interest rate -- to lower interest rates, thought you might think that Mexico will do that as well. And yes, actually, there are some analysts that are starting to expect that the Central Bank of Mexico could start actually lowering rates as soon as the second half of this year. We do not believe this. Let me tell you why. Of course,

inflation is controlled, that's a good -- that will be a good thing for the central bank to have. Nevertheless, if we take a look to the cycle of the U.S. dollar, usually, when markets start to anticipate that the U.S. might face a deceleration, the dollar declines, and because as you know, people believe that the Fed is no longer going to continue to hike rates. So that's okay, but then, when we start to see the actual deceleration in the U.S. economy, then what happens with the dollar is actually the opposite, because a lot of market participants start to do flight to market operations and go to the U.S. So in this context, unfortunately for Mexico, what has happened is, when the U.S. starts to face a deceleration, it's actually, the dollar moves up and with that depreciation, I mean, embedded depreciation of the peso, then the central bank is not able to actually lower rates as soon as that. So if you take a look to interest rates in the U.S. and in Mexico, when the U.S. Fed hikes rate, Mexico has to hike rates as well. But when the U.S. starts to lower rate, Mexico has to wait a couple of quarters to start lowering the rate. So having said this, I'm sorry for the long explanation, but I think this is very important to start to think, when the Central Bank of Mexico could start to lower rates. Now, if the Central Bank of Mexico starts to lower rates, in 2020, probably, or maybe later on, actually, as Rafael and Ursula and Marcos have already mentioned at some point in different conference calls, as you know, our asset -- yes, the way the asset mix is right now, actually it will be positive for us to have a lower interest rate because that will actually boost a little bit the economy, and the way we have now the mix will help us on that as well.

Operator

And we'll take our next call -- question from Carlos Macedo with Goldman Sachs.

Carlos Grein Macedo *Goldman Sachs Group Inc., Research Division - VP*

I have a couple. First, if you could give us a little bit of color on your expense guidance. I was just thinking through here, Interacciones is 20% Banorte and you're cutting 80% of expenses, and you have it for half a year, that shouldn't be enough to push your expense growth to 7% to 9% for the year. Is there anything else that we're missing there that pushes the level that high, and an inflation at 3.5%, with Interacciones maybe another 2%, with loan growth being a little bit weaker. What else is driving that expense level up for the year? Second question. I think, Rafa mentioned that you're proposing to the Board increasing the dividend payout, the maximum to 50%. Why stop at 50%, why have a limit at all? I mean, your -- next year, if you pay 50%, you're still accumulating capital and you're going to push above the probably the 13% Tier 1, when your target is 12%. Is there any reason why you couldn't pay more than 50% next year? Given that the outlook is still fairly benign from what I understand?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Carlos, yes. I think, as you remember, when we discussed this past conference about the expense growth, we were reaching a number around MXN 10 billion per quarter, I remember that we discussed this on the quarter. I think that when we are saying that 7% to 9% growth for the expense growth, let me just decompose those. When we reached the agreement with Interacciones, the running cost for Interacciones was MXN 3.2 billion for running the operation. That cost right now is down to MXN 1.2 billion. But that cost will be full for the year, not just 6 months, it will be the MXN 1.2 billion. So it's a very important reduction of 65% of the -- as we committed to the market. The remains, when you see the evolution of the cost line, the business growth that we have to invest -- that we have to sustain the growth of the business is adding costs around MXN 2.8 billion of cost, just the growth to sustain the growth of the business. That put us, when we add all those pieces, around 8.5% expense growth. If I take away the extraordinary items that I described to you, you should be looking at the usual Banorte running rate of 7.8%. But when you add what we integrate of the Interacciones plus the growth of the business, is when you reach the number that we are talking about, the 8.5% expense growth. That number will continue to decline, but you have to remember that when they announced the inflation, the inflation for the year, you already pay a lot on a year basis. So you are lagging like a year based on a year. So we are committed to continue to be inflation plus 150 to 200 basis points. If you extract all the elements of the extraordinary costs in 2018, that the rate of growth of the expense line was 11.3%. If you take all those out, really, the recurring expense for Banorte was 7%. So we are continuing to be very disciplined in the expense line. But -- and I think you will see now that the evolution, the integration, and all the integration expenses are fully on '18, you will have a much more clear view of the results and expenses for the year of '19.



José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

And Carlos, talking about the dividend policy, the idea is that we want to be predictable and sustainable, and that's why we say 50%. If we go further, then you will say how much this year, how much the next year. And now, with this, you know that this is going to have increase to 50%. And in the future we will discuss that, but we want to be predictable, and again, sustainable. That's the idea, and why this number.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

And one clarification -- just one clarification, Carlos, the top percent, CET1, is the floor, not the target.

Carlos Grein Macedo *Goldman Sachs Group Inc., Research Division - VP*

Do you have a target for CET1, because that would be another way instead of setting a payout, you just set a target, then you pay according to the target.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Carlos, you're right. I mean, the capital generation of the bank is quite strong because our target, as we have mentioned to the market is from 12% to 12.5%, and we are already well above that. I think, having a number of 50 at this point in time, I think it's reasonable. And as you have seen in the past, every time we see additional capital, we'll return that to the shareholders on a special dividend. So we are not warehousing capital for any reason. As Marcos says, we are being prudent on that and everything that goes above that, we will go to the board and to the assembly, to be able to pay an extraordinary dividend. But yes, your numbers are right. We will be -- we already are well above the 12.5% that we commit to the market. We are sitting at 12.72%.

Operator

And we'll take our next question from Gabriel Nóbrega with Citi.

Gabriel da Nóbrega *Citigroup Inc, Research Division - Research Analyst*

Firstly, regarding your asset quality, while we saw during the quarter that your NPL ratio has actually improved all-around, it actually got to my attention that the corporate segment actually remained at the same levels. So here I'm just trying to understand if this is still related to the specific corporate case that we discussed in the previous quarter, and if you were seeing any other deteriorations around (inaudible) the second question afterwards.

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Yes. The NPL ratio in the corporate book, if you saw, there was an increase in NPLs of MXN 250 million in the quarter. This is related to one of the cases that we have in NPLs that we have in this year, and it was just the bringing that balance to the delinquency ratio upon when it was happening. There is no effect on the reserves on that balance because the reserves were already made for the entire exposure. So that is the issue. And in the case of the consumer portfolios, the improvement is basically related to lower NPL formation in the quarter versus what we had in the previous quarters. And you can see the details in the quarter in the release of the NPL information.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

But going through this year, there's some issue with the corporate that this will be an ongoing process with one of the clients that we're actively managing this, and that's already put in the cost of risk that we gave to you. That could affect some of the numbers if that doesn't come in the right way, but it's already well budgeted for the cost of risk that we mentioned to you on this. This is an ongoing operation that has been actively managed by the corporate team and the risk management team, but we already embedded on the budget, a special numbers for that.

Gabriel da Nóbrega Citigroup Inc, Research Division - Research Analyst

All right. That's very clear. And my second question, I just want to go back to the fee issue. I understand you saying that we might not see much impacts as it is not one of the core policies for AMLO, but I'm just trying to understand if you have thought about any strategies or are you studying anything to be implemented in order to not have such a large impact to your results, if a possible restriction on banking fees actually comes into play throughout this year?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance

Obviously, we have different scenarios for different level of fees that could happen. And that space that we put on the buffer on the budget is already in place on the budget. We are not sitting idle looking at what could happen on the fee side. We have room on the fee page. We have room in other areas of the fee line. So no, we're actively managing that number. We would not like to give any number of the market and specific numbers of what we are looking at potential buffers that we put on the budget, but we are actively seeing scenarios for that, but it's already fully embedded on the budget that we are giving to you.

Gabriel Casillas Olvera Grupo Financiero Banorte, S.A.B. de C.V. - Deputy Director General of Economic Analysis

Also, Gabriel, one important thing, I want to highlight here. This is an issue in politics. So we're also acting on the politics side. I mean, remember that President AMLO has a businessman advisory committee. This advisory committee only has 8 Mexican businessmen, and one of the businessmen is our Chairman of the Board. So I think that, that's also important to highlight.

Operator

And we'll take our next question from Arturo Langa with Itaú BBA.

Arturo Langa Itaú Corretora de Valores S.A., Research Division - Research Analyst

My first question is related to the new payment system, the CoDi. I was wondering if -- you mentioned that this will provide the opportunity to access the lower income groups of the Mexican population. And I was wondering if you already have, maybe, quantified, maybe from 2020 to beyond, the potential market size or the potential increment to business for the bank. And in that regard, I was wondering if you could share with us some details regarding your digital platform, maybe for example, what percentage of origination is coming in through the digital channels or also, for example, what type of technology, in terms of client service, you're using? And how is that evolving? And maybe, if you could sort of pan out how that would look, maybe, in 3 to 5 years?

José Marcos Ramirez Miguel Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member

Arturo, the first one, the CoDi, I will ask Manuel Romo to help us a little bit. Remember that in Mexico, 85% of the transactions are made in cash. So the room for improvement is there, and we will know of these clients and know how the -- I don't know behave, and then, make them enter to the bank. Please, Manuel, go ahead.

Manuel Antonio Romo Villafuerte Grupo Financiero Banorte, S.A.B. de C.V. - MD of Consumer Products

Yes. Marcos, thank you. Arturo, good morning. The opportunity of these new transaction is huge. We estimate that, on cash transactions, it's around USD 600 billion a year, which is the 85% that Marcos mentioned. So our expectation is that throughout next couple of years, say, we can get from cash 2%, 3%, which is the rate that has been coming -- has been happening in Mexico in the last years. So in the past 10 years, we estimate that probably 7%, 8% of cash was transferred to digital. If we keep that rate, and obviously, we hope, and we are going to put all the efforts to make it faster, this could really change the landscape of payments of Mexico. As you were saying the transaction is structured, and this is in accordance with all the banks, all the participants in the bank in the market, jointly with Banco de Mexico and the rest of the authorities. It's a transaction -- going to be basically a push or pull payment, typical the one that you see in other countries is going to run through SPEI, Banco de Mexico, but it will allow to see continuous reviews on the customer experience and how much of the -- how much change in the behavior of cash is happening in the bank segment. Another interesting thing for us, and Marcos mentioned in the opening statement, is that it is going to provide us with information in order to further go, not only in the benefit of cash versus digital, but also, know the customer and start seeing if there are opportunities regarding financial products that we can cross sell. So that's basically what we are looking for, the pilot of the transaction is going to start, we expect, in the second Q of this year.

And formally, what we are -- what we expect is that the transaction will be up and running in the last Q of 2019. So it's one of the top priorities for all the banks. We're very enthusiastic about this initiative, and we are even more enthusiastic that is something that is supported by the new government as a priority. Regarding service -- digital service and platform, I'm going to turn it to Rafael Arana.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes. Let me just give you the breakdown how we are running the bank on the digital transformation, and then I move into the technology side. Of the total transactions of the bank, 6% happen at the branches, 46% happen at the web, 22% happen at the ATMs, 9% happen at the mobile, 2% on the call center, and 2% on corresponding agents. The fastest-growing channel is the mobile, obviously, and the more we integrate services to the mobile, and it's becoming the channel of choice for our clients. When you talk about digital and how we ambition and how we are using the digital and where we -- how we are supporting the digital piece, I think there has been a strong evolution in the past 3 years. We had started by disassembling the core, isolating the core in order to make that very flexible. Now we have an architecture that allow us to really move very fast in aggregate, APIs or whatever you wanted to put on top of our applications. The mobile application has been regarded with NPS close to 72% -- 71%. So it's very well regarded in the market. The web page is -- the web application is considered the best in the market. So we are investing heavily in the digital channels, using the latest technology, as you know, we partnered with IBM, but it's not our only partner. We also have partners like SAP or Microsoft, special partners for special developments in the fintech area or pieces like that. So what you will see the bank evolving into the next 2 years is a completely self-serve bank that a client can do whatever they want, with the channel they want. And in order to sort it out -- this out, there's a big push right now in biometrics in Mexico to out indicate the client in order to avoid now the necessary movement for the client to the branch for some transactions. When we finally implement the biometrics that should happen at the end of this year, then you will have, really, the full digital platform available that we can use and serve the client without the use of the branches if he decided to do so. Right now, it's a mix of the branches and the digital world, and we will -- are pushing hard to move everything into the digital piece. So what you will see a bank in 3 years is a full integrated bank with a lot of platforms like Amazon, like APIs, like PayPal, like we are today, a very flexible API platform for us and a seamless experience for the client when he decides to do business with us.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Right now, we have 1.7 million clients using the digital channels. And the idea is this very year, to end with 4 million. More than double.

Arturo Langa Itaú Corretora de Valores S.A., *Research Division - Research Analyst*

That's very useful. If I just may then, just a very brief question. How would you think about the fintech space then in Mexico? Do you see it as a potential competitor? Or maybe it's more of a symbiotic relationship? What are your thoughts?

Manuel Antonio Romo Villafuerte *Grupo Financiero Banorte, S.A.B. de C.V. - MD of Consumer Products*

We love them. We love them. No, I think that -- we're working with them. We're very close with them. We are, in several lines of businesses, we service them and in other cases, we partner with them. So we're very active in that. As long as it provides a very good service to our customers, we're open to new ideas.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes. We have a very open platform. We don't close -- we don't close to anything -- as Manuel says, if we see something that is valuable for our client, we don't mind to integrate to our platforms that fintech or service or application. That's what we decide a very open architecture in the way we decide -- build the technology platform of the bank.

Operator

And we'll take our next question from Jorge Kuri with Morgan Stanley.

Jorge Kuri *Morgan Stanley, Research Division - MD*

Rafa, you mentioned that there was MXN 2 billion in net income in the second half of 2018 coming from Interacciones. The question that I have is, what's embedded into your 2019 guidance of MXN 35.8 billion to MXN 36.8 billion in terms of pesos coming from Interacciones? And then, my second question is something that Marcos mentioned, he alluded that you guys were expecting a less

challenging year than what the market seems to expect. If I look at your guidance, again, basically around MXN 36 billion to MXN 37 billion for the year, consensus is at MXN 36 billion. So right there, where you see the year. So my question is, is that comment sort of like meant to be interpreted that you think there's upside to the guidance that you're providing? Are you shooting maybe for the high end of the guidance to be sort of like your floor? Or was it more in the sense of looking at the valuation multiples of where your stock is trading at?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

No. No. No. It's not looking at valuation. No. No. And I think, I will take the first question, basically, on the -- what we expect for Interacciones on the -- if you look at the acquisition, Jorge, for the year, that was MXN 3.7 billion, we commit the market from MXN 3 billion to MXN 4 billion, it was ended at MXN 3.7 billion, and you basically as we put on our report, it's close to MXN 2 billion, as you mentioned. For the next year, we think, we will get around MXN 4 billion at least from the Interacciones transaction.

Operator

And we'll take our next question from Claudia Benavente with Santiane (sic) [Santander].

Claudia Benavente *Santander Investment Securities Inc., Research Division - Research Analyst*

I was trying to get like a figure for the net income growth for Banorte as a stand-alone bank, excluding Interacciones. Do you think 10% is fair, 10% year-on-year growth?

Ursula Wilhelm *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR and Financial Intelligence*

Well, Rafa just mentioned that he thinks Interacciones is going to provide close to MXN 4 billion in profit this year. So just do the math.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes. It's the MXN 4 billion, Claudia.

Claudia Benavente *Santander Investment Securities Inc., Research Division - Research Analyst*

Okay. Perfect. And just to double check, so you have incorporated in your guidance the estimate that you consider fees could be reduced?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes. There's several initiatives to compensate lines of potential fee reduction. Yes. And I also, if I can take the opportunity, I would like to go back because, I think there was some misconception about the rate of growth of expenses. It was 11.2% for the year. I think there was extraordinary, on the 4 quarters that you mentioned on your report, that it really makes the difference of the big jump on the third quarter to the third quarter, but for the full year, it was the 11% that we mentioned. And now, all the integration costs and everything are in 2018. So we are looking at a very clean rate of growth in the expense line that will allow us to reach the efficiency ratio that we commit.

Claudia Benavente *Santander Investment Securities Inc., Research Division - Research Analyst*

One final question. Infrastructure loans, where do we see the growth in 2019?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

I think it would be very difficult at this point in time. I think the infrastructure team is working high. We already budget those numbers, but to give you a specific breakdown on that, I'm sure it will change for the first quarter. So we'd rather wait for the first quarter, and then, once we see the evolution of the new government and interaction, we will be much more precise in exactly the breakdown on infrastructure on the state and federal loans.

Claudia Benavente *Santander Investment Securities Inc., Research Division - Research Analyst*

And in that respect, I'm not sure if you are going to refinance any government, [limit any] government loans that Interacciones used to do? Or you are just going to let those expire?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

No. No. No. We are actively maintaining the size that we have in the market, and we are actively moving the infrastructure piece as we mentioned when we -- on the acquisition to be one of the main pieces of growth. States and federal will remain more fees, and really, the growth will be coming much more from the infrastructure small loans that we mentioned when we acquired Interacciones. But at this point in time, it will be difficult for me to give you a specific number, Claudia. I think, on the MXN 4 billion, it's what we did different scenarios, so that's the number we end up with.

Operator

And we'll take our next question from Carlos Gomez with HSBC.

Carlos Gomez-Lopez *HSBC, Research Division - Senior Analyst, Latin America Financials*

Going back to Jason's initial question about the adjustment of MXN 4.3 billion. I guess we're still struggling with the logic as to why that has to go through now, and it has to go through equity. If you look at items in the balance sheet, are you also looking at the goodwill? And when would you be, I mean, you have to look at it every year. Are you planning to do any restatement of the goodwill, which is now MXN 45 billion? And if so, when should we see it through? And a recent question, what's your expected tax rate for 2019?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Carlos, the reason that we adjust that is under the methodology that the CNBV allows when you decide to change an accounting methodology that you have presented to the CNBV. We have been always been using a very asset methodology to value the assets. And the reason for that, when we apply for -- to go against returned earnings as we mentioned, is because we were deteriorating that number by MXN 1.3 billion on a yearly basis, and there was still 3.4 more years to keep deteriorating those. So we present a new methodology that is based upon the net flows of the assets that we have, that is a much more asset methodology. We present that to the CNBV, the CNBV approved that. We presented to the Audit Committee and to the Board, and that was accepted. It's not that it's something out of the blue. We have been working this for at least the last 3 years, and this was the right time to did it. If you look at the movements on the capital, you have to go back to '17, because that was in November of '17 when we moved that MXN 4.3 billion up to the group, and then down to Solida when the reduction was affected. So this has been ongoing, and presenting, and working very closely with the CNBV in order to do this. On the goodwill, there's no way to really write down the goodwill under the Mexican accounting principles. So that will stay as is, and that's what is contemplated fully when we do our calculations with the return on equity. On the third one, I missed the third one, Carlos, so if you...

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

The tax rate has been 27 and 29.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

Yes. The tax rate, as Marcos says, we have always been guiding the market. Our tax rate is 27 to 29 that compared to the market, we are always the ones who pay -- end up paying on the high end of the market. It's 27 to 29, usually, the rate that we end up paying.

Carlos Gomez-Lopez *HSBC, Research Division - Senior Analyst, Latin America Financials*

In this quarter, it was particularly low, 23%. What was the reason for that?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

The reason for that, there were several provision that we were remaining on past revisions that we have with the authorities that we were completely clear of those. So we released those provisions on that, Carlos.

Operator

And we'll take our next question from Alonso Garcia with Credit Suisse.

Alonso Garcia

My question is regarding your guidance. I just want to confirm if your guidance includes any sort of impact on your fee income line coming from regulatory changes? And/or maybe a proactive move on your end to try to reduce the regulatory noise. I think I understood, previously, you had 12% growth in fee income line for this year. But I just want to -- doing the numbers with your guidance, trying to reconcile -- I don't get to a high number as that, as 12%. So I just want to confirm what is the correct number, and if it includes any impact on regulatory changes in the fee income line?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

No. On the guidance, the adjustment that we made is based upon the -- on the numbers when we do the overall budget. I think that if you go line-by-line on the report of the fees that we charge, we don't see any reason why those fees should go down, and remember that we have been growing in the fee base because we have been creating a sales force, specialized sales force that allow us to reach clients outside our branches that we have been now reaching a level of expertise and productivity that allow us to have a reduction in the fee base that we have. So we -- that's the reason that we -- when we look at the 12%, that's the number that we are giving to you. We are confident that we could reach this number.

Alonso Garcia

Okay. Perfect. So no impact whatsoever?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - COO, CFO and General Director of Operations, Administration & Finance*

No.

Operator

And there are no further questions at this time.

José Marcos Ramirez Miguel *Grupo Financiero Banorte, S.A.B. de C.V. - CEO & Proprietary Board Member*

Well, thank you very much, and see you in 3 months more. See you.

Operator

And that concludes today's presentation. We thank you for your participation. You may now disconnect.

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