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Q2 2021 Grupo Financiero Banorte SAB de CV Earnings Call

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PRESENTATION

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Good morning. I am Tomás Lozano, Head of Investor Relations, Financial Intelligence and M&A. Welcome to Grupo Financiero Banorte's Second Quarter Earnings Call for 2021. Please note that today's presentation may include forward-looking statements that are subject to risks and uncertainties, which may cause actual results to differ materially.

Our CEO, Marcos Ramirez, will provide highlights for the quarter, which show the evolution of a continued recovery in the Mexican economy, although some sectors are still affected by the COVID-19 pandemic. Later on, Rafael Arana, our COO and CFO, will provide further detail on asset quality, rate sensitivity and updates to our guidance. We will conclude our call with a Q&A session. Thank you. Marcos, please go ahead.

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

Thank you, Tomás, and good morning, everyone. It's good to be here with you once again. The second quarter of the year was marked by a general sense of economic recovery. GDP growth estimates for Mexico have been revised upwards, now reaching close to 6%, driven by the strong commercial ties with the U.S. economy, together with a faster-than-expected reopening of different industries in Mexico. Tourism has also surged with occupancy rates in the Mexican Riviera and Los Cabos reaching more than 80%. However, the rest of the country has had a lower occupancy, but business tourism is still lagging.

Despite having a slow start, the vaccination program in Mexico has evolved positively with more than 50 million doses applied for the most vulnerable sectors of the population and now advancing towards the younger age groups. As the third wave of contagion spreads in Mexico and around the world, we have not lowered our guard and will continue to observe strict measures to protect our customers and employees and we'll continue to implement prudent risk policies.

The increased economic activity during the quarter took its toll on inflation which reached 5.9% in June, thus triggering the Central Bank to make an unexpected 25 basis point hike to the reference rate, reaching 4.25%, ending a constant cycle that lasted for more than 2 years. Our economic analysis teams expects additional hikes to the reference rate for the rest of 2021, estimating it to end the year around 5%. Later on, Rafa will go into more detail regarding our sensitivity to rates and Gabriel Casillas is available, too.

Another relevant milestone during the quarter was the outcome of the midterm elections in June. [As no party] gained qualified majority in the lower house, it is expected that some pent-up investments and business decisions across different government and commercial sectors should begin to materialize throughout the second half of the year and into 2022.

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Shifting gears into the financial results, Slide #4. Net income for the group has gradually recovered with June's results already reaching the pandemic levels. Capital accumulation at the group level still has an impact on ROE. However, return on equity at the bank was about 20% in June, reaching 20.7%. In line with the regulator's guidelines, we have resumed dividend payments distributing 25% of the 2019 net income in May, and we have received authorization from the Board to distribute 25% of the 2020 results, which will be paid later in this year.

Slide #5, net interest income from the loan portfolio increased 2% versus the previous quarter. However, on a group level, NII was affected by results from the insurance businesses, which was impacted not only by a seasonal decline in premium origination, but also by higher COVID-related claims, as we will see later in our results by subsidiary. Noninterest income was impacted primarily by lower trading results, which were affected by back-to-market valuation on some instruments derived on the recent increase in interest rates.

Net fees, Slide #6, had a relevant 2% increase during the quarter. Digital adoption from our client base has driven a 10% increase in electronic banking fees. Economic reactivation is evident in both higher POS transactions and more happy consumer loan origination fees, which had a 9% increase during the quarter. However, we are still relying on external sales forces for mortgage and auto loan origination, which increased the amounts of these payers.

Moving now to Slide #7. We continue to see solid loan growth in the consumer sector, particularly in mortgages and payroll loans. Growth was partially offset by agreement prepayments in our corporate and government portfolios which led our total loans to a minus 1% contraction during the quarter. However, throughout the pandemic, we have gained 116 basis points in our total loan market share driven by important gains in our commercial and consumer portfolios.

Slide #8, asset quality continues to perform ahead of our expectations, with NPL ratio totaling 1.4% in the quarter, gradually returning to their normal operating levels across all product lines. We continue to work hand-in-hand with customers that were unable to resume bank payments after they came out of the relief programs which, as of today, accounts for 0.8% of our total loan portfolio, well below our initial estimates, as you know.

Looking at our results by the subsidiary, Slide #9, the most relevant impact during the quarter is evident in our insurance business, which relatively continues to register higher claims for COVID-19-related cases. Although lower than the previous quarter, claims in our life and health insurance portfolios are still high, and the pandemic is not yet behind us, and cases from the third wave of contagion are still among us.

The recent surge in inflation and the subsequent reference rate hike from Banxico, also had an impact in reserves and financial results in the annuities and insurance businesses. However, revenue diversification in the financial group helps to partially offset these effects. As in the previous quarters, we have included supplementary ESG information in the conference call presentation for your review.

With this, I conclude my remarks, and now Rafa Arana will give you additional details on the main operating and financial updates as well as some positive updates to our guidance based on current trends. Rafa, please go ahead.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Thank you very much, Marcos, and thank you for attending the conference. Let me just start with a brief recap of where we're standing. There was -- and thank you for the notes that we received from the analysts. Those notes help us a lot to concentrate exactly what you need to know about the evolution of Banorte.

As Marcos said, I think, we have to separate things in 2 parts. The first one, as you know, during the pandemic was to control the pandemic, to control the cost of risk, to control the evolution of the potential deterioration of our portfolio. And I think Banorte did a pretty good job on that part. There were some concerns at the beginning that our provisions were too low. And -- but we were based upon the numbers that we have, we were comfortable about the numbers.

Right now, when you look at the evolution of the income statement and also on the balance sheet, let me just give you a brief part concerning and taking into account that the first part during the pandemic was to control the deterioration of the risk. It was very difficult

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to grow into that part. So it was basically to control expenses, to control the risk and also to become a much more efficient bank and continue the evolution and transformation into the digital space.

The positive that we now see is that EPS continues to move into the right directions. So we see EPS recovering and trending again to the growth rate that we have before the pandemic. The loan growth, and there were some concerns about you say, "Well, you're getting the results, but there's a lack of growth." Yes, there's lack of growth, especially on the corporate and on the government book, but we see very good trends for the term for the fourth quarter.

On the government book, once the elections are over, we will be recovering the growth in that part. And the corporate, as Marcos said, we start to see some buildup on the pipeline. The consumer is performing better than expected. We -- right now, we see good numbers, double-digit numbers in the mortgage book. Car loans continue to reach close to double digit, and credit cards start to recover once the consumer start to recover, again, the part. Payroll loans also positive growth. So the consumer that is the book that gives us better returns, is performing better than expected, commercially starting to build up again.

So we see a third and fourth quarter much better on the corporate and the government and our continued strength on the mortgage -- on the consumer book. So the consumer will continue to do well. Now we see a 7% growth in that part, and we will continue to do so. So credit is better. Provisions are much better than expected on that part. So as we mentioned, the loan growth is mixed, but real growth opportunities, as we mentioned. Also, Marcos will make a very strong remark about that we continue to gain market share under these circumstances.

So Banorte's in a position based upon the liquidity and the balance sheet that they have that we can go into the market and buy the loans that we will like to buy. The liquidity is quite high. It's costing us on the net interest margin, even though the margin is better than expected, but the liquidity is at MXN 210 million because, obviously, there's no place to -- the rate of growth of the liquidity doesn't match the rate of growth of the loan book. So liquidity is building up. We will see a downward trend towards the end of the year because of this buildup of the pipeline that we have on the commercial and on the corporate and the government.

Capital generation continues to evolve. As you know, we already paid 25% of net income of '19, and we will be paying in the third, fourth quarter, the 25% of '20, on that part. But capital continues to build up at a very good pace, putting Banorte in a very strong position on the balance sheet. We know that what the more efficient way to warehouse capital, but at this point in time, based upon regulation, that is where we are on that part.

NIM is holding pretty well based upon the cost of funds and the evolution of the consumer book. There were some concerns on some notes that I read about the expenses should be lower based upon the lack of growth. I think we are controlling expenses pretty well. As you know, we always commit ourselves to inflation for 100 and 150 basis points. I think at this point in time, we will be at least 100 basis points below inflation on expenses.

We continue to invest where we need to invest, that is in the transformation, but expenses are very controlled on the other side, personnel and everything that is not related to transformation on that point. I would say that COVID, as you say, there's still some things to resolve, the third wave, fourth wave on that. That's why we are being prudent with the release of provisions. Some note says that we achieved the results based upon the relief of provisions. I want to note that we only use MXN 150 million in the quarter of those provisions that are related to COVID.

So basically, that was the total amount that we released in the second quarter on that. And that really proves the fact that the portfolios and recoveries are performing much better than that. So 78% of the provisions are still in case we need those provisions to be applied. So we only have been using MXN 150 million in the second quarter of that, and 78% of the provisions still are on the book to be used if needed.

The other things that say is in a nutshell that these are useful times with our liquidity going up, provisions better than expected, a lack of growth in some parts of the portfolios, but good growth in other parts of the portfolio. Some things that are very important to be related is that, I would say, people are asking when the cost of risk is going to trend again at the end of today. Though the usual numbers that

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Banorte runs, that will happen usually around the end of the fourth quarter on that part. When we see again stable numbers on the cost of risk and also on the provisions build up.

So I think we are right on target what we expect when we build up the additional provisions. And if there's going to be room for relief of those provisions, we have to see how things evolve on the potential COVID issues, but we are confident that we can release some provisions. That's -- by the way, those provisions, those additional relief of provisions is not included on the guidance that we are giving by the net income by the end of the year.

In the graph that you've seen basically is what I just mentioned about the provision and the evolution of the cost of risk and the write-off rate. The write-off that were still pending on the -- I would say, the consumer part of the book is still that some write-offs needs to happen on the mortgage book and some of the SMEs, but well below what we expected when we start building the provision. Those write-offs usually will -- they will happen at the end of the third quarter and at the end of the fourth quarter on the SME.

I want to recall that in SMEs, we -- 48% of the portfolio is under Nafin guarantees. So we are confident that we have enough provisions and that the portfolio is performing better than expected on the mortgage book. As you know, NPLs are just 1.1%, 1.2% and NPL ratio. So better than expected even before that we apply the write-offs.

If we move into the next page, I think, a relevant part is the net interest margin. As you can see in the graph, there has been a very aggressive drop on the rates, as you know, from MXN 8.6 billion to MXN 4.3 billion. But when you look at the Bank's NIM, it is now approaching the 6%, that is [4.9%], and it has been very resilient because of the cost of funds that we have been trying to achieve. Right now, we are at 46% of sales, and we would like to be at the end of the year around 40% of sales to continue the downward trend on the evolution of the cost of funds and really that will push up the net interest margin along with no more interest rates reduction in the near future.

So the NIM, a pretty good story. The mix is in the funding side is improving, 72% in our demand deposits. So that's also a good story. We are not where we want to be on the cost of funds. So there's still room for improvement on that from the 46% to the 40%, as I mentioned to you on that part.

On the next page, there has been also questions about what's the sensitivity. As you know, we are asset-sensitive as it has been in the past. So we will continue to see an evolution of the sensitivity in the balance sheet now towards a good performance for the balance sheet. So we expect the sensitivity on the balance sheet to continue to evolve on a much positive numbers closing maybe depending on the -- on how fast and how deep the interest rates go up to 100 basis points, close again to the usual number that we have, the 1.2 -- MXN 1 billion, MXN 1.2 billion. The next page, please.

Expenses that there were some comments that, as I mentioned before, that we needed to be more aggressive on the cost side. I think we are being as aggressive as we can, but we are not touching the transformation piece. We continue to evolve on the digital space, as I mentioned before. And there's also been questions about that when we start to producing the numbers for Rappi and for the digital bank. I think we need to wait at the end of the year for the Rappi numbers. I will give you in a nutshell.

We are right on target to achieve the 400,000 credit cards that we commit into the market on the milestones that we need in order to continue to invest. We are right at 200,000, as I mentioned, and we don't see any problem to reach the 400,000 at the end of the year. Once we have all the acquisition cost and the evolution of the numbers on the risk side, we will start producing metrics not really the income and balance sheet, but the metrics concerning about our commitments to the market when we signed the deal with Rappi.

On the digital bank, we continue right on track. We're waiting for the license to happen. We are -- as I mentioned before, at the end of July, we started to test our family and friends, the initial stages of the product evolution and presence to the market. So we are also right on target on that. As you know, both of those initiatives, we expect to breakeven around the third year on both of them, but we will continue to provide once we normalize the run of the businesses, metrics in order for you to see the evolution of those 2.

So expenses under control will be below inflation, and we write as I -- where we will see the guidance, we see that we will continue to be

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on a downward trend on the expenses. This is creating an issue concerning the cost-to-income ratio because the cost-to-income ratio is around 44%. That is well high -- is quite high compared to the usual 40%, below 40% that we run the bank with it.

One thing that is important to consider in the cost-to-income ratio is that because of the need to create those provisions on the insurance business, and the margin has been affected and is affecting the margin of the group, around MXN 2.2 billion. So if you go and put that on a recurring basis because once we start going back to normal that we think that's going to happen at the end of the third and the fourth quarter on the insurance business, you will continue to see a good evolution on the cost-to-income ratio, not because of the rate of growth of expenses, because of the lack of growth on the revenue side, mainly on the insurance side that is caused by extraordinary items like the COVID issues and the technical reserves pile-up.

So you will continue to see a good evolution of the cost-to-income ratio once we normalize the COVID issue with the insurance business. So expense is under control. Cost-to-income ratio above what we would like to be, but it's a very specific reason and it's a nonrecurring one.

On the next one, basically, the capital that there has been questions related to what's going to happen with the payout ratio. As you know, our commitment to the market is to stay at 12% to 12.5%. On the core Tier 1, we have 15.2%. Most of the dividend we paid is already warehouse at the group. So there's still a lot of room to the payout ratio. And once we get the goal from the authorities, we will start to normalize again the payout ratio.

Do you see also in this graph, the numbers about liquidity is extremely high. We really like to run the liquidity numbers of the bank around MXN 135 million to MXN 140 million, but this is because of the lack of growth on the loan book. But I want to stress again the first part of the process was to control the pandemic really take care of the capital base, take care of the liquidity. I think we did a good job on that part.

Now we have some good patches of growth in the consumer and we expect some good growth also on the corporate and government side in the next months. But the first part was to control and to take good care of the balance sheet and on a capital base on the liquidity prices, I think, also, Banorte did a good job on that part. And we are ready to go back into the market. As we -- as you can see on the gain in the market share, minority is really extremely well positioned for growth in the outbound. So please, next.

Now if we like to give you a heads-up about the change of the guidance. There's no dramatic changes on the guidance, but they show a trend. The loan growth, we are reducing the loan growth because we even -- we expect good growth on the turn in the fourth quarter. We only have 2 more quarters to grow the book on the corporate and the government book. I think we will achieve the numbers that are there on the consumer. We are already there on that part.

NIM contractions, we see better numbers on the NIM contraction. I think it will be trending more to the minus 10 based upon what we mentioned about the evolution of the funding side, the mix and the growth on demand deposits. Expense growth, below inflation, 4.2% to 4.6%. That's where we want to be on that part. Efficiency, once we start to normalize the provisions on the insurance side, we will trend again to the 41% to the 42%. The cost of risk better than expected, and I think that will continue to be a good story on this part.

The tax rate stays the same. Net income, we now are pushing our numbers. And it's important on the net income to consider that we are not taking into account any relief of provisions on this number that I'm giving to you, of those 78%, there are still pending to be released on the market. Return on equity for the growth, from 16.5% to 17.5%. This is important to notice that these are final numbers for the year. This is not the average number for the year.

And the return on equity of the bank, we now see that the number should be more close to the 19% by the end of the year. We already see in June, as I mentioned to you, and numbers above 20% of the return on equity for the bank. The GDP inflation rate, inflation is very sticky. So it will put pressure on the interest rates on an upward trend, and GDP, 6%, 6.5%. But this is a confusing number because what we need is more confidence in the investor side to really be aggressive on the investment side and move to the corporate book more into that.

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With this, I close my remarks and now I pass the word to Marcos again.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Thank you. Thank you, Marcos and Rafael. Now we will continue with our Q&A session.

QUESTIONS AND ANSWERS

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

(Operator Instructions) We will start the first question from Ernesto Gabilondo from Bank of America.

Ernesto María Gabilondo Márquez *BofA Securities, Research Division - Associate*

Marcos, Rafa, my first question is on NIMs. Your new guidance is showing lower pressure. And it seems that it implies an important expansion in the second half. So do you think this is a combination of no longer having the same impact in the insurance business plus higher rates and loan mix, considering that the retail started to grow this quarter? And also, as you mentioned, by better funding costs. So I would like to know what will be really the driver for the NIM.

My second question is on asset quality. As you mentioned, and there is in your presentation, asset quality has been behaving better than unexpected, especially in consumer and mortgage loans. However, we noticed a pickup in the NPLs of corporate loans. So can you all elaborate if this is related to a specific corporate?

And finally, my last question is if you can elaborate on your Google strategy, and how would you pretend to use it with your digital banks? And also related, how can remittances business help you to bring funding for your new platforms and potentially attend the on-bank segments?

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

Well, thank you, Ernesto. A lot of questions, I hope -- the first one, regarding the NIM, you named it, it's all of them. Yes, all the expansion, the high rates, all this is going to help on the combination. We still don't know exactly how much of each of them. But all of them, we are very positive that all this will happen, no? I will go first with Paco Martha with the Google strategy, and then we discuss the other questions.

Go ahead, Paco.

José Francisco Martha González *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Digital Business Officer*

Thank you, Ernesto. The alliance with Google has several different options and different streamlines. We are going to work on strategies around cybersecurity, we're going to work on a strategy around open banking. We're going to run on strategies around beta and help to explore the data, artificial intelligence and all the search changes that Google Cloud has. So -- and nonetheless, we are also working with them in how to take advantage of their culture and their working methodologies.

So we're going to leverage that not only in the digital banks, not only in the Rappi card alliance and in the initiative of the digital bank but also in the digital transformation that we are doing in Banorte, no? So we already have some 3 different projects: one, migrating solutions to the cloud. We're going to migrate the ERP, as I mentioned, implementing some cybersecurity tools within Banorte, the digital transformation of Banorte. So it's a range of a lot of opportunities that we are seeing with this alliance.

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

Thank you, Paco. Please, Fernando, talk about the asset quality in the corporate loans.

Fernando Solís Soberón *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Development Officer of Products & Segments*

Sure. Thank you, Marcos. I will say, Ernesto, that regarding the wholesale loan book and specifically the corporate loan book, up to now, we are dealing with isolated delinquencies and remote past due loan cases. However, we are very well aware and on the lookout of any hint or indication of a systemic risk type of case and/or situation. This is -- not has been the case of up to now.

We consider that this metric is going to be lower as soon as this month because of sustainable payment. That status, it's going to decrease by the metric you're looking at. So we are not worried at this case, and we have seen that recovery rates, write-offs or closures have gone very, very well. And this metric is just -- will improve in the short term.

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

Thank you, Fernando. Maybe, Rafa, can you help us with the remittances?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Yes. As you know, we are a very important player on the remittances business. And the good thing about the digital offering into the market is that because the acquisition cost is so low and a lot of the remittances now are flowing on a digital space, we can really offer a wide range of segmentation process to the low end of the market with the remittances at a very, very low cost of acquisition that will help us our funding, as you mentioned on that part.

So one of the key elements of the digital offering is that once you reduce the origination costs and the acquisition cost, you can really serve a wide range of segments with specific value propositions for each of them. So we see a very good opportunity. We're already doing a lot of digital on the remittances side, I think, we have been doing in the last 2 years. But once we offer the full range of value propositions to digital bank, remittances will be a key element on that to serve the -- I would say, the low end of the market that can become bank arise in a very efficient way to the digital offering.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

We will take our next question from Eduardo Rosman from BTG.

Eduardo Rosman *Banco BTG Pactual S.A., Research Division - Analyst*

I have actually 2 questions regarding, let's say, regulation and fintech ecosystem. I think the first one would be interesting if you could share with us an update on CoDi. As you know, like in Brazil, Pix has been a huge success. So why CoDi has not worked in Mexico yet? And what are your expectations for it going forward? This would be my first question.

And the second one, also comparing to what's happening in Brazil. We've been seeing like a boom in Brazil's fintech ecosystem, right? Naturally, this is hurting the valuation of Brazil's -- of Brazilian banks, right? And in Mexico, I think, we are probably going to see that as well, right? So we do have a new bank, MercadoLivre investing more and talking more about growing in Mexico. How do you see the landscape for that in Mexico? I know that Banorte has been doing some partnerships and some investments as well to prepare itself. So it would be interesting if you could share your thoughts on these 2 subjects.

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

Thank you, Eduardo, very interesting. Yes, the boom that we are watching in Brazil is going to be the same in the fintech ecosystem in Mexico. So in some other of time, we will be prepared, and that's why we have all of our capacities looking at that for sure, the scenario, no? So I will ask here, Paco Martha to share what's going with the COVID -- sorry, so with the CoDi, and also with the fintech deposits.

José Francisco Martha González *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Digital Business Officer*

Thank you, Marcos. Thank you, Eduardo. Let me start with the CoDi one. Although the number of transactions has been growing tremendously, at least for us, the transactions that we have sent year-over-year has grown more than double, and the received transactions is like 40%, 50%, let's say. We agree that it has not been able to launch as expected. The way we see it is that there's no -- any incentive in the market for the people to transform their money to the digital money, no? And CoDi is built for people that already has an account.

And even we have, for example, the possibility to create an [n2] account the in Banorte's web and you can use that for CoDi. There's no incentive to transform your cash into the digital world. So we're working with the authorities to be more inclusive in the ecosystem and be able to really move towards financial inclusion.

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Around the fintech boom in Brazil and Mexico, soon you will include in your new bank and MercadoLivre sentence, you will include Rappi card for sure. We are seeing it. We are seeing the banking commission approving the fintech, some of the fintechs. Some of them will have a lot of conditions, but obviously, the market is moving towards that. But I will like to remark that neither fintechs are nirvana and the banks are the devil, no? So there's a lot of gray notes in the middle.

And we have to work with them. We are using some of the fintechs that are in the market, for example, for our payments, for our marketplaces. So it's more a matter of taking advantage of them and them taking advantage of our capabilities. Because at the end, what we believe is that the customer needs the trust and the trust is not easy to build and Banorte has a lot of trust of our customers.

Eduardo Rosman *Banco BTG Pactual S.A., Research Division - Analyst*

No, no, great. Just a follow-up here on the CoDi subject because I think you mentioned something very interesting, the incentives, right? So what could change do you think if -- I don't know, maybe if the government starts paying all the benefits through these digital accounts and maybe incentivize kind of people to use that digital money, maybe this would force merchants as well to start accepting, right? Maybe this would be a way to think about it.

And the other thing would be -- as far as I know, and correct me if I'm wrong, only banks are allowed to manage CoDi, right? I think in Brazil, we do have, let's say, payment institutions, some other fintechs, which are able to be part of Pix, right? Naturally, it's different, right? But would that probably -- do you think if those 2 things happen, do you think that this -- maybe things could accelerate for CoDi?

José Francisco Martha González *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Digital Business Officer*

Yes, for sure. But let me tell you that not only banks can manage CoDi, big retailers are already managing CoDi, like Walmart and Comercial Mexicana, they are using CoDi. But at the end, you need to have an account. But I agree with your first statement. If we are able to ask that the services that the government provides, let's say, power, energy, water, they need to be debited automatically in an account that will create a more financial inclusion.

So we are asking them, for example, to include QR codes for the transport in Mexico, the boxes and some other transportation. And let me tell you -- I'm looking at my notes, I don't exactly know the perfect amount, but we're talking with them because there's -- if we are able -- the same way that we have the [n2] accounts that require less documents and allow your customer easier procedure, if we can also exclude -- and obviously, it's not our decision, but if we can also exclude some kind of accounts from the taxes regulation, that will create a more financial inclusion.

Rafael Víctorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

If I just may add one thing about what Paco mentioned, I think, the evolution in Mexico concerning the fintechs and things is more similar to what is happening in the U.S. that the systemic banks, the large banks are becoming faster and much more agile, investing a lot in transformation and digital and having digital offerings into that. And during the pandemic, as Paco mentioned, I think, people also look for strong entities to have their money with you, no?

On the payment side, on the transaction, maybe there's a room for that. But what we see in the evolution of the pandemic and what's the trend in the U.S. and in Mexico is that the big banks are becoming more and more and more agile and bigger and faster in order to really complement the digital offering in the market.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

We will take now the next question from Thiago Batista from UBS.

Thiago Bovolenta Batista *UBS Investment Bank, Research Division - LatAm Equity Research Analyst of Banks*

I have 2 questions. The first one is a follow-up on asset quality. When you look to the NPL ratio of Banorte still, I can say, well below the pre-COVID level that used to be, let's say, close to 2%. Do you see this NPL ratio returning to this pre-COVID level? Or are you seeing any change in your portfolio that may maintain your NPL ratio below the pre-COVID level? So this is the first one.

The second one is about payout ratio and the capital of the bank in the future. Even considering the second payment of dividends of this

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year, your core capital will be very strong, in my calculation over 14%, probably one of the highest along the other banks. And when I look for the Mexican bank season, I do not see loan growth more than double digits or achieving the double-digit level. And if you assume ROE of Banorte returning to the high teens, the bank do generate a lot of capital. So my question is, do you see a much higher payout ratio in the future for Banorte? Or do you see other ways to deploy this capital? If there's any special segment where M&A should make sense? So trying to see how your capital will evolve in the future and how to deploy this capital.

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

Thank you, Thiago. The second is a top 1 because we are alert as we don't know still what we're going to do, but we can do everything. So that's a good news. So as soon as we have a clear strategy on that, we will go with you. But yes, you are right. We are creating a lot of capital, which is -- and we will see what are we going to do in the near future, maybe then we do. And the first one is also very interesting. We will go to the 1.9% around that. And then depending if the consumer grows more than the others, obviously, the consumer needs more reserves. So we will change, because of the good reasons, maybe to 2.1% around that. I will leave Gerardo to give you more color on that.

René Gerardo Pimentel Ibarrola *Grupo Financiero Banorte, S.A.B. de C.V. - Deputy MD of Corporate Banking*

Yes. I will thank you, Thiago, for the question. That's a question that we make ourselves daily. And obviously, asset quality predictability has significantly increased. There is more clarity in the retail side of the loan book, and we expect to approach a normalized trade risk metrics scenario no later than the end of this year. When we look at the capacity loan segment of our loan portfolio, it is being successfully managed in an assembly line-type approach that is from delinquency management all the way up to legal collection if necessary. Recovery rates, write-offs for closures are going on very well. And up to now, past-due loan portfolio, sales are not being considered. On the contrary we are buying, not selling, and recovery rates are -- have been performing very, very well.

Structurally speaking, we will leave any possible structural change on quality credit metrics together, and we are very expectant to witness that. We have taken a very active role in managing the past due loan portfolio and managing the wholesale side of the loan book as well as the retail side of the loan book. So we remain very optimistic on quality loan growth prospects. And up to now, these past-due loan ratios have been performing very well, as you have seen.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Thank you. We will now take our next question from Tito Labarta from Goldman Sachs.

Daer Labarta *Goldman Sachs Group, Inc., Research Division - VP*

A couple of questions also. First, following up, I guess, on margin, but specifically on the insurance part of it. When do you think that the insurance business begins to normalize? Do the claims normalize already in 3Q? Do you think you still have some pressure on the claims related to COVID in 3Q and 4Q? So just to get some color on how much the insurance will benefit margin going forward. And just to clarify, the guidance is for the bank margin or is it for the group? Just want to make sure I understood on that.

And then just one quick follow-up on the dividends. Just any color you can give on your conversations with the authority. If you think you will be able to pay out more this year or will you only be able to do the 25% of 2019 and 25% of 2020 this year? Any color you can give on that would be helpful.

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

I will start with the third one (inaudible). The conversation with authorities, they know what's going on worldwide and here in Mexico. So they need to know what's going on and then they move to Mexico. That's -- it sounds like that is a -- so we will keep from them soon, and as soon as they know that we are in control is going to be like in the old times. So let's say that. So let's wait a few months, and that's -- we have like 2, 3 months with the rest of the world. That's my point of view. So they will move as I assume as the world is ready and we are ready, which moves me to the first one -- question. The insurance business will normalize. I don't know. We hope that we normalize very soon in some matter of time. The third wave is here among us, thanks God. We have a lot people sick but they are not dying. So it's totally different now the game. And maybe Fernando Solís can give us more color on that. Fernando, are you there?

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Fernando Solís Soberón *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Development Officer of Products & Segments*

Yes, Marcos. Yes, and actually it is a question that you always ask me, how do we see, going forward, the insurance business? I'm optimistic, I think it will tend to normalize. I do believe that things will be better, hope so, due to these facts. One, is that -- and is something that Gabriel always mentions. I mean the protocols in hospitals and the way to deal with COVID has improved. So even though we are experiencing more cases lately, we see them to be less severe, and we are experiencing less deaths because of that. And also, the vaccination, even though it has not gone as fast as we would like to. It is likely that the population that we insure is more biased towards being vaccinated already. So therefore, even though, if they also get sick, it's not very likely that they will die. And actually, what has hurt the book in the insurance mainly is the life insurance. Actually, in the health lines of business, things are now looking much better.

So yes, I do think that we will see better -- much more income because we will not pay as much in claims and also, we will not have to keep rising in care but not -- care but not report the reserves because we have been, as you know, accumulating a lot of money in this reserve. And hopefully, hopefully, it will be more than enough. So I'm optimistic. But we will see, as Marcos said, I mean, there is a lot of uncertainty regarding COVID going forward because we don't know some of the new mutations of COVID will become not only more severe, but also that the vaccines will not work for them. So it's something that we are not considering. Hopefully, that will not happen. And that's the case, I do believe that things will start to get better as we move forward.

Daer Labarta *Goldman Sachs Group, Inc., Research Division - VP*

That's very helpful. If I can just have a follow-up there. Any color you can give, maybe I know it's so early in the quarter, but just through July, are you already seeing claims coming down, I guess, relative to the peak? Or any color you can provide just how July has gone on insurance.

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

Yes. Absolutely. Actually, that's been the case. The claims have been reduced already.

Daer Labarta *Goldman Sachs Group, Inc., Research Division - VP*

Okay. Great. And the other one on the NIM, just to clarify, the guidance is for the bank or is it for the group?

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

There's not pickup -- the guidance is for the group and for the full year.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Now we will take our next question from Jorge Kuri from Morgan Stanley. Jorge, please unmute yourself.

Okay, if not, we will go now with Jason Mollin from Scotia.

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

I have 2 follow-up questions. First, on the NIM and the drive -- one of the drivers of looking to reduce the cost of funds, I think, Rafa, you mentioned from 46% of TA to 40%. Can you talk about what's going to drive that? Is that with TA increasing and you guys maintaining? Or what's the strategy to reduce that percentage?

And secondly, I guess related to asset quality, but you talked about write-offs, especially in consumer mortgages and SMEs need to come. If you can talk about what we should be expecting there? You did mention the guarantees in the SME book. Maybe you could talk a little bit about how that works as well.

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

Rafa, please (inaudible)

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Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Yes. The NIM, as you mentioned, Jason, is related to service. What I said is not to Tier 2 sectors to go to the 40% to service. What is driving that? As I mentioned to you, liquidity is extremely high, 210% at this point in time. Our liquidity will start to reduce because those funds are not being needed. So we can reduce the price of those phones that we warehouse during the pandemic to be ready for any need or extraordinary liquidity so that will reduce our cost of funds.

And another very good story is the rate of growth of demand deposits at the network and the commercial entities of the bank that we have been growing close to 12% on the -- on year-on-year with loan growth around 6% overall. So you see a buildup of cheap deposits are pretty fast on that. And we see that accelerating on the capacity for the commercial part of the bank networks and all the other entities to be very efficient in the race of deposits. What's driving that, I think, the simplicity that you can open an account at the bank, all the digital offerings that we can -- that you can open accounts on a digital space pretty fast and pretty easy and all the services that we provide for SMEs and all the transactional banking also. So I think it's a combination of many things, but all of them are working nicely. So that's our goal to reach the 40% of -- on said space at the end of the year. So we are confident we can achieve that on that part.

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

Thank you, Rafa. Let's move to the piece of (inaudible) 70-something, 75%, 76%...

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Yes, 77% in number of loans and 45%, Jason, in terms of balance.

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

And will we see -- but we will see write-offs in the third and fourth quarter. Should they be similar to what we saw in the second quarter or will they accelerate?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

No, I think they will be similar to that. And I think you will -- we don't expect to see a huge pickup on that. It's much more similar to what we've been going on up to today. And the reason for that is that you have specific regulations for -- as you know, we reduced the write-off period for the SMEs from 19 months to 9 months. So that's why that buildup or provision will happen until the fourth quarter on that part. But we don't see any extraordinary numbers going up on that. If you look at the NPLs of SMEs right now are pretty low compared to the history of Banorte. And that's -- and the reason for that is that we clean off the bat a lot of the book in June, past June on the write-off that we did on the SME. The other part of the -- that has to do with the write-off on the mortgage is also the period that we need in order to the write-offs, but having NPLs around 1.2%, 1.3% compared to the usual 1% that we run that book, we don't see any aggressive write-off that we need to do in the third and the fourth quarter.

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

Let me also add, Jason, that collateral execution on behalf of this government or bank agencies, it is immediate. We have a special process in which we check if all the documentation is 100%, we just collect or execute the collateral. There is no delay, and we currently are working with Nafin (inaudible). So that's been functioning very well. Those programs are on a case-by-case basis, but the majority are sectorial based, depending on economic activity. That will give you more color in what those kind of guarantees work.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

Jason, just one more thing. When we approach the -- at the beginning of the change of the new government coming into place, every time that happens, you usually get the SME affected by liquidity. So we bought a lot of guarantees before that. Then the pandemic hit, but we're already in a very good position with 48% of the book already under Nafin guarantees. The rate of claims that we have in that part is around -- on a monthly basis around MXN 90 million, MXN 7 million on that part of guarantees. So I think it costs us because it reduces the profitability of the SME book, but this has been pretty good for the health of the portfolio.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

We will go back to Jorge Kuri from Morgan Stanley.

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Jorge Kuri Morgan Stanley, Research Division - MD

I have 2 questions on your guidance, if I may. The first one is on the provision. On the cost of risk, you are at 1.9% to 2.1%. I'm having a tough time seeing how can you get to those levels. It just seems like a really big ramp-up in provisions in the second half of the year. You did 1.5% in the first half. So in order to get to that midpoint of 2%, the provisions for the second half would have to be like 2.5% of average loans. How do you get there? I mean, do you think maybe that there's potential upside to these numbers that provisions can be lower? Or is there anything that we're not seeing that you are? But 2.5% in the second half is a really big jump versus where we are now. And then I'll ask a second question.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

If I may start, and then -- Jorge, remember that when you see the drop because of the relief programs, you basically put on standstill for like 6 months in some of the portfolios on that part. So if you look at the graph that we project on the -- on how the evolution of the cost of risk goes on the book. When we see the what you call a big ramp-up is really the normalized number that we have been running the portfolio at because that really is coming back to normal. It's not that it's a big ramp-up. If you consider that, you have to consider when we were on a standstill basis like for 6 months on that part. So when you compare the numbers, you have to take into account that process.

When you talk about the big ramp-up on the numbers is really now -- it's a pretty normal tendency that will be below the current number -- the usual numbers that are not to run the cost of risk. So what we're seeing is a better number once you take into account the relief programs that we did. So by aiming to have around 2% cost of risk at the end of the year, 2.1% is even much better than before the pandemia. So the ramp-up that you're talking about is really taking into account all these standstill process that happened when you go into the relief programs.

And once you normalize the growth, as Marcos mentioned, on the consumer and everything like that, then you start getting into the usual numbers that Banorte has been running. But these numbers are going to be below the usual numbers that Banorte has been running the cost of risk. So it's really not a ramp-up. It's a normalized process in order to go once you clean the portfolio, you go back to normal and you take away all the remains of the relief programs that happened into that. So I think you will see that a lot more clarity on the third quarter, but it's really what we see and are really looking is an extraordinary behavior of the portfolios that we have been taking. As Gerardo mentioned, you'll see some issues on the corporate that we sorted out and balance that out. But we don't see any ramp-up concerning that [TDT ratio] or anything like that. That's why we are changing the guidance to going below the normal numbers that Banorte has been running the cost of risk.

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

And I may add, Rafa, if I can, this lower part of the interval, the 1.9%, it's a metric that applies for the 12-month period that has the benefit of a longer time frame. But also, I would say, and I think I can say that the 12-month average of that metric is already 1.9% as of now. So what that tells you, Jorge, is that we are being conservative. And yes, there is some upside expected in managing this type of metric. So -- and that's the case because we have seen throughout our internal processes of origination all the way up to collection. So they have been performing very well.

Jorge Kuri Morgan Stanley, Research Division - MD

All right. And then so if indeed you're going to see 2.5% in the second half, again, in order to get to that 2%, that's -- and again, I didn't mean ramp-up in the sense that is extraordinarily high. I see historically, your provisions have been higher. I'm just talking about a ramp-up second half versus first half of this year. And so then what provides the offset? So what -- how do you offset that?

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

I'll tell you first, Jorge, if I may, is that the historic number for cost of risk is going out of that 12-month window. I think that explains what you're seeing or what you're saying in a different language. And I will add to that the internal initiatives that we have in order to execute in a very good level of performance.

Jorge Kuri Morgan Stanley, Research Division - MD

All right. Maybe we take this off-line. And let me ask my second question, if you don't mind. It's on the credit -- also on the guidance, sorry. On the credit growth, in order to get to that 5% to 7% growth year-on-year, the quarter release for the third and fourth quarter would have to have like a 3% sequential growth for both quarters for you to get to that number, which is evidently a pretty strong ramp-up relative to what we saw in the first half of the year, which was basically flat or actually slightly down. So what gives you confidence that you can accelerate as rapidly over the next 3 months and then again over the next subsequent 3 months?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

Do you want me, Marcos, to go into that?

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

Yes, Rafa. Yes.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

Jorge, the first thing is that, remember, the big tickets come from the government book and from the corporate book. The consumer is already getting to that number and will continue to go above that number on that part. The credit card was the one that was lagging and now is recovering. So we don't see an issue on the consumer to ramp up. So the big tickets needs to come from the corporate and to the government on the federal side and on the states and municipalities. We stopped completely the lending process because of elections since the beginning of the year on the government book, basically on the states and municipalities. So now we are back into the market on that.

On the corporate side, I would say, honestly, that's the tricky one, because it has to do with the confidence that people has about investing on. And we think that once -- now that the elections are over and we see a lot more balance in power in the houses, confidence is coming slow, but it's coming back again. So that's where we are really thinking that those tickets will come from there. Restart of the government lending part and also from the corporate pipeline that is already building up. The commercial, I would say, is more advanced in that pipeline. I think we've seen much more than that.

And remember that because of the elections happens on that, there were a lot of prepayments on the corporate part. So some of those will come back again, and Banorte is in a position, because of the balance sheet that we have, to really go for those loans once now that the companies feel more comfortable about investing in that. So as you say, it's a ramp-up, yes. This is -- this one really is a ramp-up, and -- but we think we can do that based upon the potential demand that we could have because we restrained that demand before the elections.

Tomás Lozano Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A

Thank you. Now we will go with Alonso Garcia from Credit Suisse.

Ricardo Alonso Garcia Crédit Suisse AG, Research Division - Research Analyst

My question is on the fee side. And what sort of net fee growth is embedded in your net income guidance for the year? I mean, so far, we have seen a very nice recovery in core banking fees, 28% of -- year-to-date compared to last year, but have also seen pressure on the fees paid. And so all-in, net fees are flat year-to-date. So could you please elaborate on the sources for pressure on the fees paid side? And yes, what is your expectation for net fees for full year?

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

Thank you, Rafa, please go ahead.

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

Yes. Alonso, thank you. And as you said, I think I would like to separate your question in 2 things. The first one, as you mentioned, we see a very strong recovery on the activity of the bank on the transactional side. As you mentioned, the fees -- the banking fees are really well above that and the fees paid are basically related to the external sales force that we needed to develop in order to keep on moving on the needle on the mortgage side and on the car sales. So fees paid that are up 31%, as you see on the numbers. These fees are part of the

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origination thing on the acquisition cost that you pay that once you acquire the loan. But we need to reduce that sales force dependency once we see much more normalized thing on the -- on how customers are coming back to the normal relationship with the bank. And also, at the same time, we are working a lot on the digital origination part on the mortgage side and on the car loans, like launching marketplaces and things like that.

So the pressure is coming from these external sales forces that you will see a reduction in the coming months on that part, and you will continue to see good growth on the transactional and activity fees coming from the banking side. But just 31% was the cost of these external sales forces that is part to the acquisition cost of loans that stay with us for 15 -- 12 years. So you pay that once, but you keep the benefit for the next 12 years and on the card loans for around 3 or 4 years. But you will see a reduction in that part in a downward trend in the coming months, Alonso.

Ricardo Alonso Garcia *Crédit Suisse AG, Research Division - Research Analyst*

And based on that, what is the sort of net fee growth that you are incorporating to your net income guidance?

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

I think the net fee growth should be above the -- I would say, well above the loan growth. So it should be around 12% -- 11% to 12%.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

We will now take the next question from [Edson Moria from Genomix].

Unidentified Analyst

I have a couple of them. The first one is on service fee. But specifically on electronic banking. Of course, if you compare to the second quarter '20 versus second quarter '21, there's an increase of 58%. However, when you compare to the first quarter '21, there's a 10% increase. So the question regarding this is this 10% as an overall, it's because higher volume or higher fee from electronic banking services.

The second one is regarding brokerage business. You mentioned in the earnings report, 126% in trading income and a 9% in increases in fee charge, if I remember correctly. So I was wondering if you can give us more color about this.

And the third one is on inflation. Last week, we heard from Jamie Dimon (inaudible) saying that inflation is not transitory and whatever that means. However, what are your expectation on inflation? It's transitory? It's not? Maybe we are going to see a higher inflation from not only the rest of 2021, maybe 2022?

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

Thank you, Edson. I will start with your third one, the inflation -- I mean Gabriel. So Gabriel, go ahead, please.

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

Thanks, Marcos. Thanks, Edson, for your question. Yes, we think that inflation, there are big chunks that are definitely transitory and temporary, like commodity prices and certain things, in which the supply side will actually respond to the demand shock. But definitely, there will be some not so transitory pressures. And I think the places like Mexico will experience that. So we are expecting inflation to end this year at 6.1% and inflation to end year 2022 at 4%. If you need like a more -- if you need me to elaborate more, just tell me and we can do it off-line.

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

Paco?

José Francisco Martha González *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Digital Business Officer*

The first one, Edson, it's volume. At the end it's volume. The 10% increase that you were highlighting, it's based on volume.

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Unidentified Analyst

Okay. Makes sense. A quick follow-up on this. So basically, maybe, let's say, in -- for the second half of the year, let's say, it's going to be like a trend around 10% or single-digit number.

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

Go ahead, Rafa, please.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

No, it will be around 11%. If you go to the numbers on the service fees, like, for instance, fund transfers second quarter of '20 to second quarter of '21 are growing close to 12%. If you go to account management fees, that is basically the more that have been affected because of the opening of accounts that were on a physical that now we move to digital. That's the only one that has been reducing on that around minus 3%, but the electronic banking services are going up 40%. As Paco mentioned about volume, there's no change in that. So you see any line on the fee side is going up in an important way.

If you talk about trading, what's going on, on the trading side? The trading up compared to second quarter of '20 was up 32%, and it's basically about activity and volume on that part. So I think related to your question, what we see is the bank becoming much more active than before the pandemic. (inaudible) has been pushed by electronic numbers and digital origination pieces. But the bank is fully active now on that, and that's why you see the growth well above the -- on the fee side, well above the loan growth on that part. And that will continue in the third and will pick on the fourth quarter.

Unidentified Analyst

Okay. And last -- I promise this is the last one. Regarding being fully back at the offices, what are your expectations? It seems like as an industry or the banking industry, it's like in a hybrid mode. So could you give us a little bit more color or your comments on this?

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

We will take it easy. It's not so easy. So we don't want to be the first one and announce something. So it's working. So we will go like these 2, 3 more months, and we will see from there. And then we will go to the hybrid model because we love to do that. Remember, we have this lower 1 to 3. It's become compare (inaudible) the year '23, that means in no sense for the customers, for investors and also for the employees. So if we can move on that hybrid model and it's working, we want to be there. So the idea is to move slowly in the right direction and see what happens and adapt to the new circumstances.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Thank you. Now we'll move to Carlos Gomez from HSBC. Carlos, can you unmute yourself, please?

Now we will go with Arturo Langa.

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

So I know you've talked in detail about this already, but one of the scenarios that maybe could play out is a third wave of COVID and corporate, especially with a much less desire to have a credit demand because of the lack of visibility. And on the flip side, as inflation creeps up, maybe you could face some pressure in terms of deposits of especially institutional deposits looking to maybe have a higher share of time deposits or things like that. So it contrasts a little bit with your outlook on NIM. But I just wanted to ask the question specifically. Should I attach like a high probability of that being a potential worst-case scenario? Do you see anything like that as a concern? Or what is the degree of confidence that you have in the scenario that you presented in your earlier remarks?

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

Rafa.

Rafael Victorio Arana de la Garza *Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer*

No, I think what you mentioned is -- has to do with 2 things. First, you have to take into account that we have excess liquidity, and that liquidity is costing us, but that liquidity will be following out again into the market because we don't need that. And that basically --

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some of that liquidity has a high cost. So that will continue to trend the cost of funds down to support the expansion on the margin. The growth in the consumer book will continue to be there. It has been there. The third wave of the pandemic, if it happens, as you know, and Marcos mentioned, has different variance now about people continues to work. Now it seems like we learned to live with this issue. So it's not like the first one that everything was locked down. So now you see activity going on with the different ways of related demand and supply and things like that. So I think that will continue to be there.

And on the funding side, when usually happens -- what happened with the pandemic is the consumers tend to save money a lot. So that helps the bank on the funding side. It doesn't help a lot on the lending side but on the funding side continues to do so. And when you have a stock of loans like Banorte has a big stock of loans on that, that you can serve them with a lower cost of funds that will also support your margin even if loan growth is not where you want loan growth to be. So I don't see anything that could really hurt the margin unless there's a tragedy going on, on the market, but we don't envision that.

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

Yes. No, that makes a lot of sense. I think my follow-up question would be, in the total number of clients that you have, maybe you can compare, for example, your banking clients with your insurance clients, I think that penetration continues to be quite low. Just maybe what would be your outlook in a couple of years in terms of cross-sell and maybe where the cross-sell ratio is at right now where you want it to be?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

Yes. The cross-sell ratio is close to 2.1%, and we need that number to really ramp up to the 2.3%, 2.4% on the gross (inaudible). A lot has been doing in the digital analytics piece in order to really move into personal offerings to the client. I think you will start to see that in the remaining of the year, a much more aggressive trend into that. I think we have a very good source of relationship with the mortgage group that we are becoming one of the leaders in the market on the mortgage origination part. So that's also a very important piece. The same on the car loans side.

Now we see a rebound also on payrolls, and payroll, you have to segment those by earnings, but we also see that potential in that. But I think our main goal is to really, really become a relationship bank. I know everybody is talking about that. But we are putting everything and all the pieces in place in order to really achieve that based upon lifetime value of the client, offering the client not by product. So all those changes that have been going on, but it takes time to really implement. I think we are now fully into implementation mode into that point.

Tomás Lozano Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A

Thank you. We will go back to Carlos Gomez-Lopez from HSBC.

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

Very simple question, similar to Jorge, your tax rate so far this year has been on average 24%. You are guiding for 26%, 27%. So that would imply something like a 29% in the second half. Is there a particular reason for the tax rate to be so high?

Rafael Victorio Arana de la Garza Grupo Financiero Banorte, S.A.B. de C.V. - Chief Financial & Operational Officer

The only reason is the expansion on the revenue side that you need to pay more taxes on that. That would be the only reason for that.

Tomás Lozano Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A

And now we will take our last question from [Federico Galassi].

Unidentified Analyst

A couple of questions, if I may. The first one is, and going back to the question of provisions. When I looked at the first 2 quarters, the provision was about -- around MXN 6 billion. If we assume this 1.9%, 2.1% -- 1.9% that you expect for the year, we have to assume something like MXN 10 billion in the second part of the year. This is -- and I understand that the seasonality that you have always. But this is -- again, it's a big jump. You're more conservative you're expecting something there? This is the first question.

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And the second question, sorry, if I may, is when I see the past-due loans, there was a big jump quarter-over-quarter in the size of corporate. This is related to one particular launch or there is any other (inaudible)?

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

Thank you, Federico. Gerardo, please go ahead.

René Gerardo Pimentel Ibarrola *Grupo Financiero Banorte, S.A.B. de C.V. - Deputy MD of Corporate Banking*

Yes. I will tell you, Federico, that yes, you nailed it. For the second half of 2021, we are expecting a seasonally higher cost of risk. That's the short answer to your question.

And for the second question that you're making, I will tell you that those cases are isolated. I will tell that some of the economic activities that corporate NPLs incurred by the second quarter of this year, such as the cardboard consumer packaging business, we have a nonperforming loan of that type. Another example is a City Hotel with character problems on behalf of the entrepreneur. So as you can see, and I want to exemplify any other case. But those NPL cases in the corporate side are exemplified by that type of activity, and they are not systemic risk in nature. So we are comfortable. And obviously, we do not expect that this situation comes to an end until the fourth quarter of this year. So that will give you some color about the NPLs that corporate banking has incurred in the second quarter of this year.

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

Yes. And also Federico, the second half, we're expecting less prepayments, better loan growth. And overall, I think it's very important to mention again that the guidance, as Rafael mentioned at the beginning, is conservative and does not consider any reversal of provisions.

Unidentified Analyst

Last question now from my side. If you can remember that, how is the participation of the banking click?

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

Around 3%.

Unidentified Analyst

Around, sorry?

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

3%.

Tomás Lozano *Grupo Financiero Banorte, S.A.B. de C.V. - Head of IR, Financial Intelligence and M&A*

Thank you, everyone. With this, we conclude our presentation. Thank you very much.

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