Q2 2013 Earnings Call

Company Participants

- Luiz Carlos Angelotti, Executive Managing Director and IR Officer
- Paulo Faustino da Costa, Market Relations Department Director

Other Participants

- Boris Molina, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Mark Jason, Analyst
- Regina Sanchez, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. We would like to welcome everyone to Banco Bradesco's Second Quarter 2013 earnings results conference call. This call is being broadcasted simultaneously through the Internet in the website www.bradesco.com.br/ir. In that address, you can also find a banner through which the presentation will be available for download. We inform that all participants will only be able to listen to the conference call during the Company's presentation. After the presentation, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996 (sic; "1995"). Forward-looking statements are based on the beliefs and assumptions of Banco Bradesco's management and on information currently available to the Company.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events. And therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Banco Bradesco and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Paulo Faustino da Costa, Market Relations Department Director.

Paulo Faustino da Costa {BIO 6436050 <GO>}

Good morning, everyone. And thank you for participating in our Second Quarter conference call. We are here to provide you with all the information you may need about our numbers. And this is in line with our goal of always increasing the transparency of information disclosed to the market.

We have here today Mr. Julio de Siqueira Carvalho de Araujo, Executive Vice President; Mr. Marco Antonio Rossi, the Chief Executive Officer of Bradesco Seguros Group and Bradesco Executive Vice President; Mr. Luiz Carlos Angelotti, Executive Managing Director and Investor Relations Officer; Mr. Moacir Nachbar Junior, Deputy Officer.

I will now turn to Mr. Luiz Carlos Angelotti, who will lead our conference call. And after his presentation, we will be open to answer your questions. Mr. Angelotti, please go ahead.

Luiz Carlos Angelotti {BIO 4820535 <GO>}

Good morning, everyone. And thank you for staying with us in our Second Quarter 2013 conference call. I will now deal with some highlights of -- and still strong -- our financial statements, point out that they were prepared under 100% Central Bank accounting rules.

Slide two and 3 show our main period highlights, among which I would particularly like to draw your attention on slide two to our adjusted net income of BRL5.921 billion in the first half of 2013, 3.7% up on the same period last year.

Another highlight was the 10% increase in the period of our net credit margin, that is the distinct provision for loan loss. And our total assets, which came to BRL897 billion, 8% up on June 2012.

On slide 3, it is especially worth noting our assets under management, which ended the quarter at BRL1.234 trillion, a 9.1% increase over June 2012. And our 90-day delinquent ratio, which recorded an important 50 basis points reduction in the last 12 months, closing the quarter at 3.7%, as well the expansion of our 90; and 60-day coverage ratios.

Slide four shows the reconciliation between our book net income and the adjusted net income. This quarter the only non-recurring business was the provision for civil contingents in the gross amount of BRL48 million. Adjusting for this event, our Second Quarter adjusted net income came to BRL2.978 billion. Also on this slide, you can see that our adjusted return on average equity came to 18.8% in the first half of 2013.

The slide five shows our historical series of our quarterly net income. Net income growth in the Second Quarter of 2013 was mainly due, first, to a higher business volume which provided for an increased fee income; second, to our reduction in the delinquency; and third, to the fact that operating expense grew below inflation rate in annual terms. These positive factors were offset by reduced net interest income due to lower gains from -- at the non-interest earning portion.

In comparison with the first half of 2012, adjusted net income moved up by BRL209 million or 3.7%, due to, first, the upturn in the interest earning portion of the net interest income due to the increased volume of operation; second, the expansion of the customer base which helped push up fee income as a result of an increased transaction volume; third, increased revenues from insurance operation; and fourth, reduced delinquencies.

Earnings per share in the last 12 months increased by 3.3% from BRL2.70 to BRL2.79.

Slide 6, we can see that the increase in both the 12 months and Second Quarter efficiency ratios was essentially due to the reduction in the net interest income in turn mainly due to lower gains from the market upsurge in the quarter. The blue line shows the efficiency ratio adjusted to risk, which remained flat over the previous quarter at 52.6%.

On slide 7, we show that our shareholders' equity had a reduction in the period due to the mark-to-market of securities accounted for as available-for-sale. This procedure had no impact in the period results, nor did it have -- it will have any positive or negative economic effect, since these securities are linked to the Company's liabilities, aiming at eliminating risks and ensuring that their terms and the rates match.

The accounting rules provide for the mark-to-market of the securities. But not -- but do not permit the mark-to-market of the respective liabilities to which these assets are linked. If this were permitted, there would have had been a reduction in shareholders' equity.

As you have already seen, our total assets reached to BRL897 billion, BRL66 billion or 8% up on June 2012 in the six-month period. Return of average assets totaled 1.3%, while the adjusted return on average stood at 18.8%.

The Basel ratio closed the quarter at 15.4%. The reduction was basically due to a lower subordinated debt volume and the negative mark-to-market adjustment of securities profile as available-for-sale. This reduction was partially offset by the decrease in the capital requirement for loan operations to large corporates.

On slide 7, you can see also -- you can also see a stimulation assuming full implementation of Basel III requirements as of June 30, 2013. This slide shows the Company enjoys a comfortable position, what enables a full implementation with no main impacts.

Slide eight shows the relative share of our main operations in net income, both in the quarter and the annual comparison. It's worth mentioning the increased relative share of loans boosted by a reduction in delinquencies. And also the increased share of fees due to an increase in the customer card -- customer and card base, which consequently helps push up transactions' volumes. In the annual comparison, the reduced share of securities was mainly due to lower gains from market arbitrage.

On slide 9, we see that this quarter unrealized gains totaled BRL12 billion, BRL8.3 billion down on the previous quarter. The reduction was basically due to the negative (inaudible) as available-for-sale and linked to our liabilities, as we mentioned. The reduction has no impact on our results and the -- was offset by the appreciation of our investments, especially the Cielo shares.

On slide 10, we show the evolution of our unrealized gains for the past five years. The highlight is the strong growth of June 2011 and to the end of 2012. During this period, our unrealized gains went from BRL10.6 billion to BRL24.9 billion, an increase of BRL14.3 billion, which basically refers to the reduction in Selic base rates.

Starting January 2013, expectation of interest rate increase became strong with increases taking place in April and May 2013, which provided for a return of part of pervious generated unrealized gains.

On slide 11, we show the evolution of our net interest income from both non-interest and interest earnings operations. This quarter the reduction in the total net interest income came from the non-interest earning portion, reflecting lower gains from the market arbitrage.

It is included in non-interest earning gains from the partial sale of (BMF) shares, amounting to BRL148 million pre-tax. In the annual comparison, the 1.6 increase in the interest-earning portion was mainly due to the upturn in average business volumes lead by loans and insurance.

Let's look at slide 12. The annualized net interest margin reached 7.2% in this period, remaining stable over the previous period. We expect this period to record a gradual reduction by the end of 2013 as it may reach 7%, mainly to a higher pressure on spreads arising from stronger competitiveness. This drop will be offset by lower provisions for loan loss due to the increase of -- due to the decrease in the delinquency ratio.

Slide 13 gives a breakdown of our -- of the interest-earning portion of the interest income, which was positively affected this quarter by, first, loans due to the increase in business volumes; and second, funding reflected the upturn in the interest rate. The highlight in the annual comparison were loans and insurances, which were positively affected by the increasing business volumes. The decline in the funding margin was due to the reduction in interest rate during the period.

Looking at slide 14, I would like to call your attention to the net credit margin, the blue area of the chart, which went up by 5.5% in the quarter and 10% in the six months period. And was positively affected by higher business volumes and also by the reduction in delinquency cost, which fell for the fourth consecutive quarter and is shown in the red area of the chart, thereby producing a lower negative impact on the credit margin, representing 40.5%.

Moving to slide 15, our expanded loan portfolio totaled BRL402 billion in June 2013, 2.8% up in the quarter and 10.3% up in the annual comparison. These increases were mainly due to the increase in operations originated by individuals and the micro, small and medium companies. The segment reached 11.2% increase.

Concerning our expectations, slide 16 shows a 30 basis point reduction in the delinquency ratio to 3.7%, the level we were expecting to achieve by December 2013. It is worth to emphasis that this reduction was evident in all segments, led by the individual ratio; it fell by 50 basis points. We believe that this ratio will remain stable. But with a downward bias, once short-term delinquency posts a downward trend in all this segment. And we expect stability in the unemployment rate.

The slide 17 shows that our provisioning levels remain solid, exceeding Central Bank requirements by BRL4 billion. Assuming the maintenance of the 12 months gross and net loss ratios as from June 2012, we have booked provisions of BRL8.3 billion, above expected losses in the next 12 months, the dotted part of blue line, or even BRL11.4 billion in relation to losses net of recovery, the dotted part of the purple line, also for the next 12 months. These figures advance that our provision level under Central Bank regulation is consistent to our reassessment and provisioning policies.

Reinforcing what we mentioned in the previous slide, slide 19 (sic; "slide 18") shows the coverage ratios of the allowance for loan loss in relation to credit overdue by more than 90 and 60 days, which have remained at very comfortable levels. In fact both ratios moved up, reflecting the period reduction in delinquencies.

On slide 19, we show that the second part of fee income totaled BRL4.983 billion, 8.3% up on the previous quarter, mostly due to the excellent performance of fees from our investment banking activities. In comparison with the first half of 2012, fees from our investment bank activities increased by 54.5%, followed by cards, consortium and checking accounts.

It is worth noting that -- noting our investments in organic growth, the expansion and the modernization of the services channels, which led to an increase in our customer and card base, in turn allowing us to continually increase the transaction volumes, going up by 20% in the last 12 months, thereby push up fee income.

Slide 20 shows the Second Quarter operating expense increased by 3.9% of the previous quarter, basically reflecting higher, first, the personnel expense impacted by the lower concentration of vacations when compared to the First Quarter; and second, the administrative expense due to the increased volume of business and services. And the more business days in the period.

In comparison with the first six months of the last year, operating expense is increasing by 4%, once again reflecting our strong cost controls in this context.

It is particularly worth mentioning the active role played by our internal efficiency committee. The upturn in personnel expenses was mainly due to the salary increase of 7.5%, in line with the collective bargaining agreement.

Moving on to slide 21, we can see that the 3.6% increase in administrative expense in the quarter was basically due to higher business and services volumes. In comparison with the same period last year, the slight 2.8% upturn, if compared an inflation rate of 6%, was the result of our continuous efforts to control these expenses (inaudible) generated by the upturn in the expenses arising from higher business and service volumes. And the expansion in the number of service points.

The slide 22 shows revenues from our insurance pension plan and capitalization bond activities, which increased by 20.9% over the previous quarter, largely as a result of the life and pension plan segment, which grew by 32.2%. In the annual comparison, the increase came to 15.3% lead by life and pension plans, heath and saving bond segment, all of which recorded double-digit growth Second Quarter. And net income remained virtually flat over the previous quarter.

The 4.2% upturn in net income in the annual comparison was essentially due to, first, the revenue growth; second, a reduction in the claims ratio; and third, the greater administrative efficiency.

Slide 23 shows some of the main figures from our insurance activities. The combined ratio came to 85.5% in the Second Quarter of 2013, a 50 basis point decrease over the First Quarter. Financial assets totaled BRL142 billion, while the technical provisions came to BRL132 billion, BRL114 of which from life and pension plan products.

Slide 24 shows our revised guidance for 2013 based on the macroeconomic scenario and the business environment in the first half of -- in the first half and our expectations for the rest of the year.

We reduced our growth projection for loans when compared to our beginning of the year projection. As a result, we revised downwards our growth projections for the interest earning portion of net interest income.

On the other hand, we revised upwards our growth projections for fee income as a result of an increase in our customer and card base. And, in turn, in the volume of transactions.

We revised downwards our growth projections for operating expense to below expected inflation level, given the first half performance of these two lines and our constant search for the improved efficiency. For insurance premiums, we are maintaining our initial projections.

In conclusion, given the events that impacted the macroeconomic scenario this quarter, we believe we had a quarter of healthy results. It is also worth mentioning that our results and the indicators are sustainable, irrespective of the internal and external economic challenge we are currently facing.

Certainly these results were possible thanks to our broad business diversification and strong implementation, allowing us to pursue our business opportunity in the banking and insurance segment.

Finally, Bradesco maintains its positive outlook for Brazil in the long term, which can be seen by its investment growth strategy, which are focused on organic and consistent growth.

Thank you very much for the attention and we are now available to answer any questions you may have.

Questions And Answers

Operator

Saul Martinez, JPMorgan.

Q - Saul Martinez {BIO 5811266 <GO>}

This is Saul Martinez from JPMorgan. So I have two questions. First of all on net interest income, if I ex out -- if I look at net interest income on interest earning -- interest bearing net interest income, excluding the non-interest component, it rose 0.6% Q on Q. And you had I believe three or four more business days this quarter than last quarter.

Your current guidance of 4% to 8%, obviously it's a reduction. But it does imply that net interest income will grow off of current levels pretty nicely in 3Q and 4Q given the macro environment. Why do you feel confident that net interest income is going to grow at the rate that will allow you to get to your guidance?

Secondly, on asset quality. I understand you can't talk about specific exposures. There have been a lot of speculations in the press about your exposure to one group. You've also indicated that your loan loss provisions for 2013 in the past will be about BRL13 billion, more or less, maybe a little bit less than that. Is there any risk that specific corporate exposures could put that loan loss provision guidance at risk? Are you worried that that could be the case?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thanks, Saul. Thank you for the question. About the net interest income growth, we revised our guidance. The guidance that we have is 4% to 8%. This guidance normally is considered -- is basing our budget. We revised the growth for this year. But we understand that in the companies that we have in our net interest earning portion, net interest income, we have -- the main component is loans.

In this line in this first half, we have some effects from the new credit card portion that we adopt for the interest rate. We reduced the interest rates for the credit card revolving operations. And the new product that we have now, we intend that the clients will use more. And this is one of the effects that will help to improve more the revenues in the loan side.

We have the now -- we have the other products that we understand that will continuously grow; payroll loans, mortgage operations and the -- these products are growing more than 30% in the mortgage phase. And the payroll loans -- our internal production is growing more than 6% in the annual basis. For companies, we have the auto loans operation, the trucks loans that is growing more than 20%.

Spot finance is another product that is growing higher. Mortgage for companies is growing more than 30%. Then we understand that we will reach in the growth that we expect for our credit portfolio, that we expect to finish the year around the 13%. Then we expect more and a better increasing the first line that is loans.

In the funding revenues that we have in the net interest earnings with the modification in the Selic rate that -- and the expectation that we have the Selic rate for the year, probably we will have some additional revenues that will improve the growth.

Insurance margin we expect that to be better when you compare with 2012. Then we expect more and more growth in this line. And in the last line the securities and others, as we talked that we expect that we will -- the revenues in this lines will decrease a little more. But the final impact that we expect in the growth when you compare 2013 with 2012 in the net interest earnings growth, we expect to reach around the 6%. That is the center of the guidance. The main component is the cash growth. And this first half is affected with the credit card policy that we'll -- in the next quarter we expect more revenues from this segment.

And about the asset quality, we talked about the expectation for the expense for 2013 was -- the least that we expected was BRL13 billion compared the same level that we had in 2012. But now with the new level of the delinquency ratio that we -- the target or the number that we expect for the end of the year, we reached now in the first half. Then probably the expense will be less than BRL13 billion, probably something around the BRL12.5 billion -- BRL12.5 billion or something around that.

We cannot talk about our exposures of our clients because the best practice and the rules here that we have here in Brazil. But we revise our positions, our portfolio constantly. And we adjusted according our analysis that we having about the risk. Then we revised now in this first half the total portfolio that we have and we are comfortable with the level of provisions.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. If I could follow-up on the first question, to get -- if my math is right, to get to 4% NII growth you need to grow in the second half every -- each quarter 5% quarter-on-quarter your net interest income excluding non-interest income, 3Q versus 2Q, 4Q versus 3Q, on average 5% sequentially. It seems -- doesn't that seem to be a little bit aggressive? I understand all the different variables you highlighted. But it seems a bit aggressive, does it not?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

In this half, this first half -- in the last year when you compare the revenues that we had last year, the funding line we had more revenues because the level of the risk than in the first half of the year, last year. We had some additional impacts from the more funding revenues and a little more security and others revenues.

This year we expect to have more -- the growth of this funding line will grow more and the loan side, we expect that will have an additional revenues that will come from cards and the additional order, as I mentioned, that will help us to have a better growth. Then -- you understand that we (have) how to get or to stay according to our guidance and we expect to be -- to stay more closer to the center of the guidance.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. All right. Thank you very much.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Ladies and gentlemen. the question-and-answer session has started. (Operator Instructions)

Mark Jason, Invesco.

Q - Mark Jason {BIO 4289233 <GO>}

My question is relating to the adjustment necessary for the difference in working days. So it seems that your fees were up something like 8.4% quarter over quarter and that was impacted by advisory fees. But if we exclude the advisory fees, it was up something like 6.2%. But there was an increase in working days. So what I am trying to understand is like what would be the adjusted growth rate in fees given the impact from the additional working days. And where -- and what other areas would you see significant impact from the additional days?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

This Second Quarter when you compare with the First Quarter in many lines, you have this effect of the working days in expansions, in fees and in some revenues that we have in the loans. But if you compare in annual basis, this effect is neutral. Then we understand, okay, we have these more business days when you compare quarter with quarter, the Second Quarter with the First Quarter. But when you look at the annual basis, this problem -- we don't have this problem because the difference -- this is very small, I think one day or two days. Then, I think the better growth or the better numbers that you can see about growth is on the annual basis. And in fees expansions, this -- the main lines that we have these effects.

Q - Mark Jason {BIO 4289233 <GO>}

Okay. Thank you.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Let me ask two questions also, related to net interest income and asset quality. First, on net interest income; on your prepared remarks, you mentioned that you expect your net interest margin to be down to about 7% from 7.2% because of competitive pressure on spreads. Can you just elaborate on that? Are you still seeing the state-owned banks being very aggressive? You said your expectation that they will continue to gain market share throughout the year, or are you already seeing a more rational behavior by them?

Then second question is related to asset quality. Just looking forward, we are seeing that the economy in Brazil is much weaker than expected. It seems like you still expect non-performing loans to continue to decline throughout the year. So just wondering why do you feel comfortable that we are not going to see a pickup in NPL, especially in the SME segment. You continue to show the fastest growth in your loans. Your loan growth is actually being driven by the SME portfolio. So if you can just elaborate your level of comfort in that segment in a weaker economic environment. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. Thank you for the question, Mario. Talking about the net interest, the NIM, we finished the quarter with 7.2%. We are working for maintaining the spread stable. If you look our numbers that we have in our comments, in our book, we maintain in the First Quarter the spreads -- in the Second Quarter compared with the First Quarter was stable in 10.3%.

We are working (inaudible) to maintain the spread stable. We expected more competition. We understand that this year the private banking they will -- they are more -- they are expecting to grow more. They are trying to grow more. And we have some pressures. But we understand that our NIM until the end of the year could reach at the maximum to 7%, not less than that this number.

This effect that we talked is about -- is because this pressures in the spreads because of the competition. We see that the public banks, they are working to grow hard. But not too aggressive than they were last year or -- they are perhaps more rational, perhaps more in the level -- more in the market level.

About the asset quality, okay, the economy is weaker than we expected in the beginning of the year. Our GDP growth was -- expectation was 3.5%. Now we have 2.2%. But if you compare with 2012, we have a bad year for the expectation for growth.

Then we -- in this quarter we finished the quarter with the delinquency ratio around 3.7%. We expect that probably we will maintain this level. We expect stability for this level of our delinquency ratio. But with some bias downward for -- because the short delinquency ratio that we have in our portfolio is decreasing.

Then, probably some good effect we expect for the future. But we understand that we probably will have more stability in the delinquency ratio because the economy -- one factor is the unemployment rate in a lower level now, 5.6%, that we -- 5.7%. And we don't expect for the next year a strong modification of our economy. In fact, they expect that if we have some modification in this unemployment rate, it will be only 0.1% increase.

Then, we understand that we have conditions now to maintain stability in the delinquency ratio. And inside the Bank, our quest policy, we are working continually to maintain the better quality in the assets, to grow with quality this year -- grow with quality and with good margins.

We are investing to improving the quality of our internal models to (inaudible) approval. Then, we understand that we have to maintain this quality in our assets.

Talking about the SMEs, this is one segment that we are investing for to have a good growth. When you analyze the segment and the expectations for the future in the Brazilian economy is that these small companies, they will have a good growth for the future. Then in this segment, you have good margins to do operations. And we understand that we have how to grow in this segment with quality. Normally, our operations that we have in SMEs or big corporates. But we have the guarantees of the company or of the owner.

Then we have another thing. That is our managers in the branches, they are responsible to know the client. They go to the companies; they do a visit. They know the clients and the company. Normally, we start the relationship with small tickets and according the relation and the sort of the client, we start to improve a little more the tickets.

But all timing with the better quarter analysis, the -- with guarantees. We understand that we have how to grow. If you analyze the Bradesco performance in the last years, you can see that in this segment we are having a growth and we are maintaining a stable delinquency ratio on this segment. Then, we understand that we have how to grow with quality in this segment and in the middle segment and in the corporate segment.

Q - Mario Pierry {BIO 1505554 <GO>}

All right. So let me just go back, Angelotti, then to your answer to the net interest margin. Basically, you said, right, that you expect the NIM to reach 7% by the end of the year. But you are seeing a more rational behavior by the public sector banks, also we are seeing a much higher Selic rate.

So is it fair to assume that the 7% from your part seems conservative, especially as Saul was asking you about the net interest income growth that you are forecasting for the year, 4% to 8%. It seems like in order for you to reach the growth rate --

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Yes. It's conservative. At this position, it's conservative.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Because we understand we will have this competition. We are working side -- if you compare our numbers, you will -- we could maintain stable spreads in the first half. Then, we will work in the second half in the same way. If you really have a success -- we understand that we have, yes -- this guidance of 7% is conservative, very conservative.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Regina Sanchez, Itau.

Q - Regina Sanchez {BIO 16404038 <GO>}

I also have two questions. The first one is that we observed the large corporate loans classified as rating D, presented an increase to 2.5% from 1% of large corporate loans or approximately BRL2.4 billion in the Second Quarter. We saw that on page 40 of the MD&A.

I know you won't mention specific names of companies that have been downgraded. But we would like to know whether you consider this downgrade as one-off event, or, in other words, that loan loss provision expenses would have been lower, I mean in around BRL200 million, if this downgrade didn't happen?

And if we could expect even lower levels of loan loss provision expenses as a percentage of average loans in coming quarters, or if there is a chance that we could see more downgrades in the following quarters related to these or other large corporate loans? Then I have a second question. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. We can't comment about our clients. We are constantly revising our portfolio, about the releases. And we do the adjustments that we understand that are necessary for our clients and our portfolio. Then, it's a normal point that we have. And we do this every month. Our credit department, they are responsible for this analysis and inside of the

Company we maintain this portfolio in the better relation -- in the better position that we understand in the -- according to the risk that we -- according to our credit analysis. We can't comment about the clients because the Central Bank -- our rules here in the country and the best practice.

And for this year, what we are expecting is that our expenses, considering that now we have the new level for the delinquency ratio, we understand that probably our expense will be something around -- in the year around BRL12.5 billion or something around that, because we understand that we will maintain stable the delinquency ratio this year with some expectations to have a better -- some decrease. Then, we understand that probably the spreads will reduce a little more for the future.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay. Thanks very much. So you are saying that it should be lower than the BRL13 billon that we saw in 2012?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Yes.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Our expectation was something around BRL13 billion. But now considering this new situation that we have, probably something around BRL12.5 billion. This is not -- it's net of recoveries. This is considering the net of recoveries.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay. Perfect. Thank you. And my second question is that if you could share with us the asset liability management strategy of Bradesco regarding the banking book and more or less for the affiliated companies, mainly the insurance and pension business? Because we understand that more than half of this mark-to-market of available-for-sales securities in the equity is related to the insurance pension business, which does have a match with liabilities that are not mark-to-market in the equity.

But part of this asset liability management strategy also is increasing the (developed) risk of the Bank and the market risk that is also accounted for the capital ratio of the Bank. And also because you call my attention if this is a part of the asset liability management of the Bank to carry the national treasury note that we saw a significant increase in this quarter.

I mean on the explanatory note we saw the outstanding balance going up from BRL28 billion to BRL41 billion in this quarter. So is this a new strategy of Bradesco and now it matches with the funding of the Bank in terms of deposits, in saving deposits that the Bank decided already to walk a spread and bought this national treasury notes at a yield that was now -- was lower than the current market price and that's why we saw the negative impact in the equity of the Bank. I don't know if I'm clear. And you can ask me if it wasn't. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Okay. This asset liability management is not a new strategy of the Bank. If you analyze last year, we had the similar position in this bonds. We worked for to -- to mismatch -- to mitigate the maturity rate and mismatch risk. And this portfolio that we have in the available-for-sale is in the -- net -- around the -- totally is related to this asset liability management. We have the insurance business and we have the bank insurance and the -- we have the banking business.

We work to maintain the liabilities, to have with the asset -- to maintain the potential -- to mitigate the risks. We are -- we have this book -- this bonds that we have in -- talking about the insurance business, we have some liability in the insurance business. We have 10 years, 20 years, 40 years, then we need to have the bonds with a long-term maturity to protect the requirements -- the liabilities that we have in the insurance business.

For the banking we have the liabilities related to savings, financial and others, subordinated debt that we do the liability -- the asset liability management. And we maintain these bonds to protect these liabilities that we have in the banking. It's not a new policy that we have.

And this portfolio, the majority is in the available-for-sale and they are according the accounting rules. You need to mark-to-market these bonds, these assets, every bonds that you have. But you cannot do the -- in the liability this same mark-to-market evaluation. Then, the problem when you analyze the shareholders' equity is that we have only the mark-to-marketing the assets.

If it was possible -- were possible to have the mark-to-marketing the liability, the effect that you have in the shareholders' equity will be nil. So then we understand that in the future, probably we will continue having these effects. But these effects not produce any economic impact in our results. The important thing is that we maintain these bonds to mitigate the maturing rate mismatch risk.

Q - Regina Sanchez {BIO 16404038 <GO>}

Okay, perfect. And also if you are maintaining these bonds to match with these liabilities, with the savings and subordinated debt, was there a particular reason to increase the national treasury notes outstanding balance from BRL28 billion -- this was the outstanding balance in March 31st -- to BRL41 billion in June 30th? I mean, was it increase also on the funding of the Bank?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Every time we analyze the opportunity -- when we had this movement in the Second Quarter with the increase in the rates, we understood that it was one good moment to do the --- this asset and liability. And we understand that we have now -- our position that we have, we understand that we are confident with this position and the perspective that we have for the future.

Q - Regina Sanchez {BIO 16404038 <GO>}

Perfect.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

And we understand that we work to mitigate this maturity and the rate mismatch risks.

Q - Regina Sanchez {BIO 16404038 <GO>}

Perfect, Angelotti. Thanks a lot. I really appreciate the answers.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

I had some follow-up questions on my questions in the Portuguese call. They are both related, I mean, to the mark-to-market of the -- the bond portfolio. Regarding the -- about BRL4.5 billion took place at the Bank. And you mentioned that this is part of the asset liability management and that for that reason there will be --- the actual economic impact will not be -- would actually be zero, right.

But I have to disagree with that because when you look at the mark-to-market of all your financial liabilities -- and this is I think on page 203 from your MD&A, we actually see that the difference in mark-to-market was only on a pre-tax basis BRL830 million. And I am including the subordinated debt here and borrowing and lending all the main liabilities. And you lost BRL4.5 billion.

So it shows -- I mean there is really -- it was not asset liability management position. It was indeed more like a treasury position. And so I don't know if you could explain in more detail and how do you see that approach regarding your treasury changing going forward because of course this has implications in terms of what the trade result is going to be in the quarters to come.

I think you mentioned before that you never expected it to be back again at BRL300 million. But -- after the quarter. But I think this is -- I mean, do you think this is realistic given that you had the interest rates coming down over the years and so the available-for-sale securities, which had an impact overtime in your trading result. So how do you see that line going forward?

And my second question is regarding the sale of -- available-for-sale securities. You mentioned in the Portuguese call that there was no -- that Bradesco did not sell available-for-sales securities. But looking at the cash flow statement of the Bank, this is in the MD&A as well, we actually saw that there was almost BRL7 billion of available-for-sale instruments that were actually sold. And that information is there.

So I would like to know what was the P&L impact arising from the sale of those available-for-sale instruments, because my sense is that your trading result would actually be much lower or far more negative than what it was -- than just the BRL18 million that you reported in the quarter? Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Talking about the first question, the subordinate debts that we have -- in this calculation that we have in page 203, the criteria that we have to do the present value is different that we have for to do the mark-to-marketing in the bonds.

In this calculation that we have in page 2003 (sic; "page203"), the rates that we use in this case is the rates that we have in the last negotiation of this paper. And considering the -- not the mark-to-market rates that we have, is the rates that we have for this paper in the last negotiation. Then, it's a different criteria to do this comparison between the asset and the liability. And the -- in this position that we have in the asset liability management is we are confident that we don't have any kind of effect in -- that represents as an economic impact. This adjustment that we have in the equity is because it is an accounting effect that we have that we need to mark-to-market only the asset and we can't mark-to-market the liabilities.

And you talk about the available-for-sale operation that is -- the majority of this portfolio that we have in the available-for-sale is related to the operations that we have in the asset liability management. A small part that we have is in our trading position. Then, in the trading position is a small part. But they do the -- our credit department, they have their strategy and they do their movements.

But in this position that we have for asset liability management, we did not change the position or sell bonds. We maintained a similar position that we had last year. And we had only some increasing in the Second Quarter because we saw -- we understood that we had an opportunity for improve this asset liability management (policy).

Q - Marcelo Telles {BIO 3560829 <GO>}

Yes. But at the end of the day, I mean you had -- you sold BRL7 billion of available-for-sale instruments. So that must have had an impact on your P&L regardless. And regarding the first point on the mark-to-market regarding subordinated debt, I mean the note in the financial statement says that they are based on market prices. And in the absence of market prices, I mean they should be -- estimated in terms of price given by the distributor, pricing models.

So it seems that -- I mean at the end of the day, the market -- what you call market value of your subordinated debt is actually -- and will not be very different. Maybe have some difference or so if you are to be, let's say, less conservative. But to make up for the difference from BRL4.5 billion to BRL800 million there is a long way to go. So that will be my point.

And finally just another question. I mean your assumptions going forward, they seem still to be based on some recovery in the Brazilian economy over the next -- this year and next year as well. But now I mean I think we could all agree that the risks are definitely on the downside for the Brazilian economy. So do you have a sensitivity of what 1.5% GDP growth would do to your like NPL ratios and loan growth? Would that change your scenario a lot?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

I will speak just for the GDP growth; it's 2.3%. Then, this is what our economic department, they have now. And we changing our guidance as far as required and we are considering this -- the expectation. Our NPL, we reached now the lower level 3.7%. And we understand that we will have more stability this year, probably in 2014, because we understand that the scenario that we have for next year is that the economy will grow something around 2.5%, a little better than our expectation for this year. And the unemployment rate will be -- you can consider it stable, because only 0.1% increase. Then --

Q - Marcelo Telles {BIO 3560829 <GO>}

No. I understand your scenario. My question is, in -- I mean have you done some strict analysis in a more varied scenario? I mean would that change the strategy or lead to maybe an increase in NPLs already this year or much lower growth in loan portfolio?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Can you repeat the NPL?

Q - Marcelo Telles {BIO 3560829 <GO>}

The NPL ratio --no, my question is -- I mean I understand the scenario that you've laid out and you've become more conservative. But my point is that what if the scenario is worse than what we are seeing today. And I think there is downside to that scenario. So my question is, have you done any analysis, what would happen if the economy grows much less? I mean do you consider that in your worst case analysis, I mean have you done something in that regard and what sort of NPLs could you expect or --?

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

I don't think that scenario would be worse. What we will have is a less growing economy, what is a good growth. And probably the credit growth, the loan portfolio growth will be less than we have in the past. Sometimes in the past we have 25%, 30%. And now probably the new level that we will have for the economy is something in a more lower level, probably between 10% to 15%, 10% to 13%.

But what you have now is a new scenario for the economy. But not a bad scenario. Do you understand that? We expect in our case a stability in our NPL ratio. Considering the scenario that we have for 2013 and in the year that you will have after, our economic department they expect the GDP growth seem like grow and -- it's something that we understand to have more stability now in the delinquency ratio because this new structure that we have in the system; a lower growth for the credit portfolio. But a more stable situation in these ratios.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Thanks for your time.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Boris Molina, Santander.

Q - Boris Molina {BIO 1904979 <GO>}

Thank you. My questions have been answered. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Hello?

Q - Boris Molina {BIO 1904979 <GO>}

Hello. Yes. Thank you. My questions have already been answered. Thank you.

A - Luiz Carlos Angelotti {BIO 4820535 <GO>}

Thank you.

Operator

Excuse me, ladies and gentlemen. since there are no further questions, I would like to invite Mr. Paulo Faustino da Costa to proceed.

A - Paulo Faustino da Costa {BIO 6436050 <GO>}

Thank you, all for participating in this conference call. I would like to take this opportunity to remind you that our Market Relations department and our IR team are at your disposal. And that all the contents of our Second Quarter 2013 and all the information concerning Bradesco is in our website. Thank you, all.

Operator

This concludes Banco Bradesco's audio conference for today. Thank you very much for your participation and have a good day.