Q1 2019 Earnings Call

Company Participants

- Alexsandro Broedel, Executive Finance Director and Head of Investor Relations
- Candido Botelho Bracher, President and Chief Executive Officer
- Marcos Antonio Vaz de Magalhaes, Executive Officer & Director
- Milton Maluhy Filho, Executive Vice-President, Chief Financial Officer and Chief Risk Officer

Other Participants

- Analyst
- Carlos Goldman
- Carlos Macedo
- Domingos Falavina
- Eduardo Rosman
- Jason Mollin
- Jorg Friedemann
- Jorge Kuri
- Marcelo Telles
- Mario Pierry
- Nicolas Riva

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to ITAU Unibanco Holding Conference Call to discuss 2019 First Quarter Result. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions). As reminder, this conference is being recorded and broadcasted live on the Investor Relations website at www.itau.com.br/investor-relations. A slide presentation is also available on this site.

Before proceeding let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With that, today in this conference call in Sao Paulo are Mr.Candido Bracher, President and CEO; Mr.Milton Maluhy Filho, Executive Vice President, CFO and CRO; Mr.Alexsandro Broedel, Group Executive Finance Director and Head of Investor Relations. And Marcos Magalhaes, CFO of REDE. First, Mr.Candido Bracher will comment on 2019 first quarter results. Afterwards, management will be available for a question-and-answer session.

It is now my pleasure to turn the call over to Candido Bracher.

Candido Botelho Bracher {BIO 3158644 <GO>}

Well, good morning, everybody. Welcome to our first quarter 2019 earnings conference call. We'll start the presentation on Slide 2 where we showed the main highlights of our performance for the quarter. You see that our recurring net income was BRL 6.9 billion, which represented a 7.1% growth when compared to the same period in 2018, resulting in a ROE of 23.6%. This performance was mainly related to an improvement in our financial margin with clients, which was partially offset by a lower financial margin with the market. Our cost of credits remained relatively stable and noninterest expenses were up by 4.1% below the inflation for the period. In the next slides we will provide further details on these figures.

On Slide 3, we show the value created by the bank, which are amounted to 2.9 billion on the quarter in line with our focus on creating value for more than 1.2 million individual shareholders. Actually, let me say that BRL 2.9 billion is a record figure in our history.

Page 4. We show that our total credit portfolio grew 7.7% over the last 12 months, driven by individuals and as a SMEs which have grown 12.7% and 17.6% respectively. Origination continued strong in both portfolios resulting on richer credit mix, which will be shown in the next slide. In addition, we observed in this quarter an upsurge on the corporate origination at 18% growth, while corporate bonds issuance remains solid.

On Slide 5, the BRL 1.1 billion increase in NII was mainly due to the change in the mix of our credit portfolio as shown in the previous slide and superior average balances. This NII performance resulted on N-I-M, NIM of 10% for the quarter.

On Slide 6, we show our financial margin with the market, which are amounted to BRL 1.2 billion, well in line with our expectations and guidance.

Turning to Slide 7 now, we show our credit quality information. Short-term delinquency increased 13 basis points in the quarter due to seasonal effects on individuals portfolio related to a higher concentration of expenses of households, such as cars and housing taxes among others. It is important to mention that despite this increase and the change of the credit mix towards higher interest-bearing loans. Short-term delinquency ratio is below the levels seen in the same period in 2018.

The 90 days delinquency ratio increased 11 basis points in the quarter, that is also below the level seen in the same period in 2018. The increase in the quarter is due to a couple of cases on the wholesale portfolio, that were already fully provisioned. This event led to the decrease of our NPL 90-day coverage ratio, as we have been anticipating. It is important to highlight that the coverage ratio for the retail NPL 90 days continue to show stability, despite the change in mix towards higher risk and interest-bearing loans. Lastly, the cost of credit ratio increased 30 basis points in the quarter as would be expected given the credit portfolio growth and the acceleration of the change in credit mix in the period.

Slide 8, shows our revenues from services and insurance, which grew 1% when compared to the same period in 2018. This small growth is a direct result of the competitive environment, especially related to the acquiring business. Also of note is the impact of the regulatory cap on the interchange fees from debit transactions, which started to impact our operations on the fourth quarter last year.

Turning now to Slide 9, we show that our noninterest expenses grew 4.1% when compared to the first quarter 2018. Our cost to income ratio improved 240 basis points on the quarter but is still above the same period of last year. We intend to continue to work tirelessly to keep costs under control and improve operational efficiency.

Slide 10 now illustrates, the strong organic capital generation of the bank, as we finish this quarter with Tier 1 ratio of 14.6 coming from 13.5 in the end of 2018. The main driver of these growth was our profitability in the quarter as well as the lower density of our risk-weighted assets. Also of note was the approval by the Central Bank of Brazil of the additional Tier 1 instrument we issued under local market in the beginning of the year, which added 30 bps to our capital ratio.

Slide 11, will talk about our new initiative on the acquiring business. Hedging, we will no longer charge interest on the prepayment of credit card transactions, which were repaid in. This is valid for credit card purchases with no installments and to clients with an Itau domicile and annual revenue up to BRL 30 million, which covers about 90% -- 98% of the market. We see this as a way to better serve our clients and harmonize practices with international standards.

Now on Slide 12, present our revised guidance for the year. We revised the guidance as a consequence of 2 management initiatives. First, the new acquiring payment arrangement with hedging previously mentioned. And second, a more rigorous revision of our cost structure motivated by our perception of our more modest macroeconomic rules for 2019. The matter of fact in the beginning of the year, we estimated GDP growth of 2.5%, when we gave the original guidance and now our economic team estimates GDP growth at 1.3%. Therefore, we revised downwards in our expectations for financial margin as clients and also fees and insurance. Additionally, we reduced our expectation for non-interest expenses grow for the year. When see in aggregate these changes do not have a significant impact in the guidance implied net income.

With this, we conclude this presentation and are now open to any questions you may have. Thank you.

Questions And Answers

Operator

(Question And Answer)

Questions and Answer Operator, (Operator Instructions). Our first question comes from Jorg Friedemann, Citibank.

Q - Jorg Friedemann {BIO 15405752 <GO>}

I have 2 questions. The first it became evident in this quarter and according to what Candido just mentioned, that the environment is tougher for revenue growth and the bank is trying to curb costs to defend profitability. However, I was surprised by the significant cut in the OpEx guidance, so I was just wondering if you could provide a bit more color on the reasons behind lower cost growth for this year. Are you reducing investments in any specific areas? Or are you trying to simply optimize cost through enhancement of profits and this is the first question.

The second question, I know that you have that methodology that takes into consideration profitability and the expansion of risk-weighted assets to come up with your payout. In this quarter in particular, we saw an optimization of risk-weighted assets. I believe that this is related to a stronger growth in the retail portfolio that demands a lower RWA, and at the same time your profitability continues to be very solid. You added 8 basis points in terms of your Common Equity Tier 1 and just with internal capital generation, and in addition you also had a bit more a Q1. So, taking into consideration, all of the dynamics and where you are in terms of Common Equity Tier 1, you believe that you could have how much of payout this year?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Board Thank you, Jorg. So let me take your two questions. First, on our cost, I mean changing of the guidance in cost and then all the actions we've taken in since the beginning of the year in order to control and reduce cost expansion in the bank. Actually, I mean, they were not caused by the perception of a higher competition in the market or more competitive environment. The main reason was the perception of slower economic growth as I mentioned. When we began the year, estimating GDP growth of 2.5%, and now we're estimating it at 1.3%. So I mean when we had early on the game, the perception that the economic growth that we would not accommodate, a cost growth as we had anticipated.

And the measures we've taken, they involved in virtually every sector of the bank I mean we have gone in detail through the costs in every executive director area and the work costs reductions across the board in the bank. It didn't effect of factors specifically , nor did it affect investments specifically. Second, the payout. The payout is not a target in itself. The payout is a consequence of the level of -- level 1 capital that we want to have. The board establishes that by the beginning of the year, we should have a level of capital of 13.5% taking into consideration, we expect that portfolio growth for the year and expect that the for the year, possible investments and possible changes by the regulator, which may require more or less effective. So taking all in the year in consideration , I mean, that tells us we might begin the year at 13.5 for level 1. This is what we will continue to do and we are in terms of date, we are still following this date, it will be the year that we made these calculations and see some from today, -- date points to a significant payout again by the year of 2019.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Yeah, now that's perfect. I really appreciate, Candido. Just following up very quickly on the first point, if I understood it correct you are not curbing any investments in technology and the plans that you had in terms of restructuring some business areas such as insurance for instance. So everything continues as before is the result of the lower cost guidance is more related to enhancement of process? Is that correct?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

We are certainly not cutting any investments in technology. And to be very transparent, with you in insurance we are not cutting any investment as well, but we are lengthening the profile of the investment. Not because we wanted to save money with that, but because we found out that it takes a little longer to train the workforces that we hired. So, the rhythm of hiring is going to be a little slower than we had originally anticipated drawing.

Q - Jorg Friedemann {BIO 15405752 <GO>}

Now that's perfect. Thank you very much for the clarifications.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

Operator

The next question comes from Mario Pierry, Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good morning, everybody. Let me ask you 2 questions as well. First question, Candido you mentioned, that you now expect weaker economic recovery in Brazil this year. You reduced your GDP forecast. But at the same time you maintaining your loan growth guidance unchanged. So, I was wondering, how do you expect loan growth to be throughout the year, especially if the economy is to be decelerating, if you can talk about how you see demand from large corporate right the large corporate segment continues to contract, while consumer lending have been growing at a double-digit pace?

So, if you can just give us some color here with your appetite for lending, what kind of trends you're seeing in why you maintain your guidance for loan growth unchanged even though you expect a weaker economy. The second question is related to the strategy at hedging. It Seems like some of these change in your guidance is self-inflicted right your lower income generation somehow your margin as well as because of the actions you're taking at hedging. However, you started to be more aggressive in prices in the third -- the second quarter last year.

So, it seems to me that even though you are reducing prices, you're not seeing the benefits either in volumes or in revenues, when do you expect that to change and if you can give us some color as well with regards to the profitability of hedging on a standalone basis. If you are already operating over return on invested capital below your cost capital or if you still being profitable in the business. Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Mario, thank you very much for 2 good questions. First, the guidance for loan growth, despite the fact that we see economic growth , I mean, by ahead of what we saw in the beginning of the year. There's one factor which is that despite expecting the economy to grow less this year, we expect the potential reform to be approved in the second half of the year, and the loan growth is measured by the figure at year-end, so this plays a role.

there. A main factor I would say is that, we are feeling encouraged by the loan growth we are experiencing, not only in individuals and SMEs, but mainly in March, we saw and more recently we saw an upsurge in the demand for corporate loans if prices which are compatible with our cost of capital. So we remain confident that I mean given the expectations we will finish the year within the limits of our guidance for loan growth.

Now in relation to hedge, it's difficult to make the size forecast in a market which is changing so fast as the acquiring market in Brazil, to be honest with you. Last year as a matter of fact, we have started to lower our rates in the second quarter and as a consequence, we use leveled our market share, and we stopped losing market share. But I must say that , I think that in last year movements, we were mainly followers. I mean, we reduced our margins following the market. With this recent movement, we anticipated what we saw as an unavoidable trend in the market.

To play in is what markets in the whole world do, it didn't do in Brazil because of our historic very high interest rate, volatile inflation and so on. And in the recent stability with interest rates and inflation under control. I think we'll drive the market inevitably to the T2 standard. So here, we basically anticipated this move. And you are correct in saying that the change in guidance was mainly provoked by self-inflected measures. Beat the measures in related to hedging and 3 plus 2 the additional cost controls and cost savings that we have implemented in the year.

Q - Mario Pierry {BIO 1505554 <GO>}

Thanks. Can't you -- just a follow-up. It seems like your competitors now have been following you in reducing prices and the acquiring business as well. So, where do you think the this stops, right, because it seems like let's say, last year, you were like you mentioned being a follower, now you being a leader but then someone else might want to be a follower. How do you see the profitability of this business then over the long term?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

I think the profitability of this business will suffer. If you don't take into consideration increases in volume. And if you don't take into consideration innovations, which I think innovation which I think is inevitable in this market. But certainly, it's not a market where you can give yourself to the luxury of protecting our margins and seeing your market share be washed away very fast so, you have to play along and that's competition. Mario, wait I will ask Marcos Magalhaes, CEO from REDE to complement.

A - Marcos Antonio Vaz de Magalhaes {BIO 4657543 <GO>}

Just something I think it's important to stress of that despite competition's been very fierce on pricing, it's not being irrational competition, so we going towards maybe , like Candido said, in terms of what these standard international practices. I think that the margins of these business in Brazil will also convert to international standards and as of now we can see a couple of inches not is above international benchmark. So, that's the way that will go and again it's not at this point as we don't see the irrational competition.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. I think you're -- just to take the opportunity. When you mentioned that the profitability of margins in line with international standards, international standards don't have prepayment. Are you talking about -- what kind of margins are you talking about?

A - Milton Maluhy Filho {BIO 15220856 <GO>}

I just talking about overall margin. So if you get your ratios for free tax profit of the revenues that a good figure where mark-to-market should go through.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you.

Operator

The next question comes from Eduardo Rosman, Banco BTG

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi. Good morning, everyone. I have 2 questions. The first one is on fee income because even if we exclude hedge and the credit card business, I feel that performance overall is too weak. I know that we're seeing kind of a pressure across the board in our asset management business, investment banking, credit cards etc. So, I just wanted to get your thoughts about to know how should we think about growth in the fee business going forward. Should we expect growing line with inflation now that the new normal or not? So that's the first question.

Second question is on the value creation. When we look to your slide number 3, we can see that your value creation story reaching record high levels, right. So I wanted to ask how you think about this metric, if you believe if it's still possible to improve the gap of the ROE to the cost of equity ratio. If you think this is going to be more like the ROE going up or cost of equity needs to move down. How much can move down, so if you can talk about that as well, it should be interesting. Thank you very much.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you so much. Now first question how do we see the growth in fee income if we see it going along with inflation if this is the new normal. I don't. I think, I mean, we are living a special situation this year with the pressures from this year and next year with the pressures from the acquiring business and it's important to add the interchange tax, which was established by the regulator and started to the effect started to be felt in the last quarter of last year. And, but I see them more in combined between inflation and GDP growth. I think that as GDP starts to grow again, we will have an increasing in demand for all of this business, which generate fee income. So, I expect , I mean for this year, we have provided a guidance 2% to 5%, but I expect this figures to improve and to be better as the economy starts to grow. And the second question on value creation, I don't see this gap widening. another gap between the ROE and cost of capital. I think it is historically high level, I see the cost of capital reducing as pension reform gets approved and so on. So, yet despite not seeing this gap widening. I think value creation improved through volumes, and so the value creation is not only the result of the GAAP that is also the result of how much capital you apply, to the how much results to generate and I think that more healthy way of growing value creation will be to grow portfolio and to grow business in general, which we expect to have as the economy starts growing again.

Q - Eduardo Rosman {BIO 16314825 <GO>}

No. Perfect. Thank you very much, Candido.

Operator

Our next question comes from Jason Mollin, Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello, thank you for the opportunity to ask a question. Candido, my first question is on a follow-up on cost. We've seen Itau's focus on cost efficiency in the past of course obviously an accelerated fashion after the merger with Unibanco but it seems as if that's always been a focus for the group. What drove the timing for this renewed focus now in the first quarter versus the end of last year and what I guess you referred to as self-inflicted pain and this changing guidance? And, could we see this again? Is there more room to really tighten down more. I guess, if you look at Brazil globally cost to assets for the banks are on the high side.

So, how low can we go, and of course you just mentioned and this was related to my first question I was going to ask but in terms of value creation it really is I think important to talk about revenues and not just cutting cost. So if really you're thinking that where we are now at record value creation, very high earnings and it's not going to come with. When can we expect this volume, is it really next year or the year after ? Where can we go to in terms of that volume growth, loan growth, can we get back to 15% loan growth in Brazil. Is that where is the long-term kind of recovery in loan growth rate for you guys? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you, Jason. So, your first question on cost, what drove the timing of this measures of cost controls. What drove it was the perception that the economy would not grow as expected this year. So, when we looked at to the difficulties, we would have in growing fees and investments this year, we wouldn't get a tailwind from economic growth, we decided to be much more austere in cost management in the bank. Is there a more room to control costs? Yes, there is, I think there always is but especially with the investments we are making in technology, so we expect that over the next years. I mean we will have a significant improvement in cost to the bank. You may say also that there may be I mean all these innovations we will also bring a reduction in fees in general, in margins in general. We have our efficiency ratio now at but again I believe there is room to improve more, but taking your observation and view I mean, as to what concerns to the timing. We are now working on costs way beyond the end of this year. So we are projecting austerity for the periods ahead.

The second question concerning volumes and when can we expect them to come back. I don't have the precise figure with me now, Jason, but I have seen it recently. I'm sure that I mean incorporates we are still below the level at the end of 2014 or 2015. In individuals we are more or less about the same level of those, but taking inflation into consideration. So I believe, I mean there must be room for growth -- significant room for growth in assets and in income in the years to come. And I think what we depend is on economic growth and economic growth depends on fiscal stability and fiscal stability depends on pension reform, this is more or less how we see it, so the perspective of upholding a good pension reform in the second half of this year. I think opens very constructive perspectives for 2020 and beyond.

Operator

The next question comes from Nicolas Riva. Bank of America.

Q - Nicolas Riva {BIO 20589225 <GO>}

Yes. Thanks very much Candido for taking my question. Just two questions. The first one on capital. We did see the decline in the CET 1 because you paid the additional dividends and interest on capital. Right now, it's at 13.3%. I think you said earlier in the call, you gave target of 13.5, was that 13.5 with target for the CET 1 or actually for the Tier 1.

So, just to get an idea if you are done basically with this process of optimizing the capital structure. And then, the second question on the guidance. So, you've changed the guidance for net interest income, but again changed the guidance for loan growth. Was the reason for this basically more competition from our banks in terms of pricing or a different assumption for the celebrate? Thanks.

A - Milton Maluhy Filho {BIO 15220856 <GO>}

Thank you, Nicolas. On the first question , you are right. I mean it's for Tier 1 capital, 13.5 % is the level we want to have at the beginning of the year for Tier 1 capital. Our Core Equity Tier 1 now is at 14.6 at the end of this, our Tier 1 is now like 14.6% at the end of this quarter. The Core Equity Tier 1 is 13.3%, you are right.

The second question I mean, why did we adjust the guidance for financial marking clients and for fee income and not for total credit portfolio. One reason is because we looked mainly at self-inflicted I mentioned the self-inflicted factors in which were the measures we had hedged when adjusting the guidance. But the main factor is that we feel encouraged by the growth we are witnessing in credit demand. We are seeing a healthy demand from individuals and SMEs and starting at the end of first quarter, we are seeing an upsurge -- we also demand for corporate loans, so we feel encouraged that we will be able to meet this goal established in our guidance for loan growth also because we do expect the approval of the pension reform in the second half of the year. And I think we should drive demand for loans especially in the corporate sector even --.

Q - Nicolas Riva {BIO 20589225 <GO>}

Thanks. One follow-up there. The revenue from the prepayment business from REDE, they're all booked in the fee income line or also on the NII line? Because you mentioned REDE driver also of what happened in the change of guidance for a net interest income, but I wasn't sure if it's booked in NII or just in fee income, the prepayment business of REDE. (Technical Difficulty).

Operator

Our next question comes from Marcelo Telles, Credit Suisse.

Q - Marcelo Telles {BIO 3560829 <GO>}

Hi. Good morning, everyone. Myself Marcelo Telles, Credit Suisse. Thanks for the time. I have a couple questions. The first one regarding your NII guidance for the year mean particularly the decline NII We haven't even though you brought it down to 9% to 12%, it seems somewhat challenged somewhat like a challenging target now considering that you are like 7% up year-on-year, , so you probably have to grow 4.5% per quarter over the next 3 quarters in order to reach that target. So which to me sounds optimistic. Hello?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

We were cut, so could you please start your question again since I didn't hear it from the beginning. Sorry.

Q - Marcelo Telles {BIO 3560829 <GO>}

Of course. Myself Marcelo Telles here from Credit Suisse. Thanks for time. So I have 2 questions. The first one, the regarding your client's NII growth target of a 9% to 12%, even though you changed versus your previous guidance for a little bit. It does seem somewhat optimistic right considering that you grow a little over 7% year-on-year and it seems you have to grow 4.5% per quarter over the next three quarters in order to reach that target. So my question to you is, what makes you comfortable that you can achieve this target and especially considering that you mentioned the economy, is a little bit lower than you expected and perhaps probably the growth could be more skewed towards the second part of the year, so if you could elaborate on that I would appreciate.

And my second question is you did mention that this ongoing cost effort that now Iteu is making, it something that, it's probably not just a one-year. I think, but it's an ongoing effort. Maybe you can see that going forward. So considering that the fee growth hasn't gone down but that you're being able to really control your costs very well. And you mentioned that you do not expect your ROE, gap to your cost of equity to widen, is it fair to say that on the positive side, you can continue to keep your excess return as it is today, because you still see room to offset let's say some potential pressure, revenue pressure particularly fee side with more cost cutting down the road. And I'm look- I'm trying to look for a little bit beyond 2019 in that question. Thank you.

A - Milton Maluhy Filho {BIO 15220856 <GO>}

Okay. Thank you, Marcelo. First concerning NII growth, which I mean we are guiding it's between 9% and 12% for the year, I mean we are confident that we can do be able to deliver this growth in NII and the reasons are the following.

One is that we expect some economic, more economic activity now. We expect the pension reform approval in the second half and so. The main reason though the average portfolio growth, I mean average portfolio grows between 2019 and 2018 is much higher than we have between 2018 and 2017. And as you know, the NII is made on the average of portfolio not at the portfolio on the end of the period. So this, it gives us some confidence in the year to reach this NII target. And the other very important point is the change in mix that we are experiencing, and we are really experiencing a much more intensive growth in individuals and SMEs portfolios, were which have a better higher margin than corporates and so on. So this change in mix, as you can see by the way in the presentation, I mean this change includes the main explanation for the growth in NII.

And what concerns costs. Yes, I mean I see our cost control going beyond 2019. In 2020 I think that really we are keeping this more and more under control. I think that technology will enable structural cost confirmation in the bank, going forward. Also something that we will always require investments and I think that there is a limit to the ability to incur profitability based on cost reduction. So, we expect profits in the future has to come mainly from growth in assets and growth in -- income and economic growth in general although I mean we intend to keep costs strictly under control going forward.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thanks guys. There just one follow-up on your own the second answer. So, is it fair to say that even though you may have like some competitive pressure, some of your revenue lies that you can actually be -- no because you could continue to control cost and you probably have like a very positive credit cycle ahead that you can maintain your excess return similar to the levels that we have today, at least over the in like the short to medium term. Is it a fair assessment?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

It certainly in this direction. But for all our efforts here go Marcelo but as the example in Asia has shown you all, competition must be taken into consideration when building this the scenarios ahead.

Q - Marcelo Telles {BIO 3560829 <GO>}

Excellent. Thank you very much. Appreciate it.

Operator

The next question comes from Domingos Falavina, JP Morgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Thank you very much for taking the questions and good morning to all. Also two quick questions. The first one is just again on REDE's position. So when we look at kind of like the medium term history , REDE was one of the market share losers, I think, given the growth of CapEx in Santander all the way by growing 0% to 1% of industry growing 10% year-on-year, all the way up to the fourth ,Q of first of '17 for 4Q of '18 and what we hear on the ground is basically that there is strategy change and sort of and even management future self-changes which feature drastically as far as the profitability pool of the industry and decided to change the attitude, I should say in pricing as well.

And we start seeing volume growing basically 5% year-on-year 8%, 14%, 18% in the 4Q, which is above industry growth. Industry was growing 15%. In this 1Q we saw basically growth decelerating 14% which implies maybe in line, maybe a little bit below industry growth potential market share losses. And then we notice the second round of aggressive measures of far as the push too. And my question is at what the level of growth , assuming the industry grow15% will you be okay with the growth and is it like market growth or is it plus 1% plus 2% want to be a gainer and at what point you going to revisit price and say we have to go on our second round, so that's the first question.

The second question is on Tokpag. You have a very good app, Venmo-like, for transferring, it's been removed from the Apple Store, we can no longer download it and some of the rumors were here is that you may be launching some kind of digital initiative, digital banking around that software. Just curious to see your why exactly was it removed this is just rumor or do you have actually something in mind for more the low income portion of the population on the digital fine? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Hi, Domingos. Thank you for the questions. I will ask Marcos Magalhaes to help me with the first answer but just the first part of first question how -- why have we changed our stance in hedge in regards to the competition. So I think we changed its price. First during 2017 and so on we try to protect margins just and this evidently didn't work. So there was a moment beginning of 2018 when we decided we would play along with the market and protect our market share and this worked in the sense of protecting the market share at the expense of compressing margins, which is what happens in the highly competitive markets.

And now we have so to say taken a lead and leading the industry forwards this to keep this initiative. We are exercising and we are in constants discussion here and how to cope with this much more competitive environment. And there is a learning process, and we feel that we are doing better now. But I will pass to Marcos to complete the answer.

A - Marcos Antonio Vaz de Magalhaes {BIO 4657543 <GO>}

So two points to add to that the Domingos. The first is the different results between the first quarter of this year and the fourth of last year. , there is seasonality involved in terms of client portfolio mix. So that pretty much explains the variance of growth from the fourth to the first quarter.

Q - Domingos Falavina {BIO 16313407 <GO>}

Magalhaes, I'm comparing you year-on-year growth, so if you could explain , the seasonality shouldn't impact the year-on-year, right?

A - Marcos Antonio Vaz de Magalhaes {BIO 4657543 <GO>}

No. It does impact it because the portfolio mix changed that period. So when you look in the fourth quarter, we year-over-year and the first quarter every year the reason in the change and growth rate is related to that. Second point is our long-term pursuit here is to level market share, so we intend to, we don't have a goal to be the largest acquirer in the market in terms of market share. We do have a goal to keep the our operations relevant in market share in the market and that means for us to sustain our share on the long-term.

Q - Domingos Falavina {BIO 16313407 <GO>}

Cooper's here. So the goal is to grow in line with the market --

A - Marcos Antonio Vaz de Magalhaes {BIO 4657543 <GO>}

Yes.

Q - Domingos Falavina {BIO 16313407 <GO>}

Clear. Thank you. And on the Torre.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Board I'm sorry. On your second question on the Tokpag. Well, the Tokpag I think was a product. I agree with you. I got some criticism at home, because we had discontinued it. But the fact that the market did not seem to think it was such a great product and adoption was not to the standards that we demand from our new products in, so this was the simple reason why it has been discontinued. In what concerns I mean initiatives and we are always thinking about them. We are always working on new products to satisfy our customers, but there's nothing we could be advanced right now in this field.

Q - Domingos Falavina {BIO 16313407 <GO>}

Thank you very much.

Operator

The next question comes from Jorge Kuri Morgan Stanley. Stanley? Hold on just one second. Mr.Jorge Kuri, you may proceed.

Q - Jorge Kuri {BIO 3937764 <GO>}

Good morning, everyone. I have two questions if I may. One on the bank and another one on acquiring. Can you walk us through what happened with delinquency in the first quarter we did see and meaningful uptick in most of the metrics whether NPLs bad debt formation, renegotiated loans , cost of risk. All of them moved in the wrong direction, I guess. Is this mostly seasonal, is this mostly because the economy has been weaker than expected. Are you seeing similar trends so far in the second quarter. What's your expectation of how this is going to shape out?

And my second question. Just I guess taking advantage of Mr.Magalhaes is on the call is about rather overall from a strategic perspectives. So, I'm guessing some people would disagree that the main disadvantage was pricing at REDE. Some people would argue that and certain of your competitors argue that the difference between themselves and the incumbents is they provide much better product services, customer experience and that's what merchants really value. So, are you only going the pricing routes? And how sustainable is that strategy everyone moves to free D2 tomorrow and then you're still the same company with the same disadvantage on prices product, sorry product service quality merchant simplicity, et cetera? Or is there in addition to prices , a targeted effort at the company to try to provide a much better customer experience and hence more sustainable competitive advantages and I just may ask the third questions, sorry. You did mention that you thought that profitability had to converge to international standards because there's no reason why Brazil should have higher profitability in the payment space. I'm not sure I understand that, I mean the bank generates 23% return on equity, I don't banks globally generating 23% return on equity so, does that mean that we should also expect the bank to have in a single digit ROEs like every other bank in the world? Or how do we reconcile these comment? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Hi, Jorge. Thanks for very provocative questions as usual. So let me by the first one here on credit. And the first what's happening on credit is totally within our expectations, we are not surprised by anything that's said. It's the result of 3 movements and just remind me if I forget. The first is what we show in our product mix, and we are moving credit mix towards where there is margins are higher, but also were delinquency higher in individuals and SMEs. So this change in mix coming and the portfolio growth in itself commands higher provisions.

The second effect is the seasonal effect in the first quarter of the year that always happens in the first quarter of the year. Last year it had been weaker. It had been only 20 basis points. This year it came to 40 basis points again because it has been the previous years. So no surprised here. And the third aspect of what we do with the corporate world, which is the decline in the coverage ratio. In this decline in the coverage ratio you will remember, I have been announcing for over a year now.

And it's the results and I always say we make provisional make provisions which are precautionary. We had made quite a few of them during the years of crisis and after because there were companies which had not defaulted yet but which default as you know I mean we put the probability of default, with profitability of default we saw increasing in the period. With these companies, 2 things may happen.

One is that they actually do default. We had this case in this semester, where 2 companies did default did faster 15 to 90 days to get to the over 90 days, from here. And these 2 companies were already a 100% provisioned for a long time. I mean the second was just what we expected. And the other thing that may happen is that companies may improve simply and their probability of default may improve and then making the provisions no longer necessary for these companies. This also happened in this quarter.

We have a couple or 3 companies I mean which keep the business going so and when you combine all these easily are the expected losses in general are exactly according to what we have forecasted. And I mean you can see that it is perfectly in line with the guidance we have provided for a credit front. So I mean it's here and everything -- we have has absolutely no surprises in the credit front. I will answer the third question and then pass to Marcos to answer the second question. When I mentioned that the in the payment arena profitability I mean could go to international levels. I am just recognizing a difficult situation which is (Technical Difficulty).

Operator

Ladies and gentlemen, please hold. Ladies and gentlemen, please hold.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Hello.

Operator

Speakers, you may proceed.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Jorge, sorry, we got cut I don't know in when did you stopped hearing me.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks Candido. You were actually starting explaining the question I asked about profitability converging for payments you were just starting the answer to it.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Okay, so let me come you can't do this. So in the this comment I made is direct it derives from witnessing the very strong competition in this sector and the enormous margin compression that have been experiencing there mean, for 3 years now probably. And the market is changing here and this is a market where an innovation and technology are making a big difference as well as the normalization of the interest rates in Brazil.

So, all this is leading to this conversion which I see in this market and measures as the one we have taken this week. And they are designed to grant us, a lead in the industry and enabling us to keep on serving these clients. As broadly as we can in the bank I mean we certainly do we intend to maintain the differentiated returns on equity that we have and we think that we will be able to make it not by avoiding competition on the contrary when by facing competition directly. I will pass now to Marcos.

A - Marcos Antonio Vaz de Magalhaes {BIO 4657543 <GO>}

Okay just adding three points to what can we say if and, when talk about conversions remember that also the product the way it works in Brazil is conversion also to international practice for example. Rent, something that is very typical of our market. It's an existence in our marketing that is going down towards the sale of the POS for example. We talked about segment period which also shortening by stronger competition and by also strength of regulation of these. These conversions is making the product converge to international practice that's where we for it will convert the profitability on that segment as well. Talking about their service and our user experience that's a very good question Jorge thanks for bringing that up. Certainly we are focusing on that. We have many accounts working on improving our customer service or the user experience. We have goals to increase of NPS All of our employees have goals on that respect. But linking to what we did in terms of pricing change is that by our measure half of the gap in the NPS towards our competitors is by virtue of pricing. So NPS measures subsection, but a further subsections comes also from pricing, So, half of the difference, half of the gap is for pricing. That's why we decided to level that.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thanks everyone for your thoughtful answers. Thanks a lot..

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

Operator

The next question comes from --, Santander

Q - Analyst

Hi, Candido, and thank you for taking my question. It is just one and it's related to the guidance for the year. There were too many revisions, one of the revenue side and the other on expenses. So sorry for my insistence on this topic, but my point here is that given that the competitive scenario in the car industry is becoming day by day more challenging. We do understand there was some change already this strategy. Thus the change the guidance of the year.

But on the other side since the management of operating expenses rely basically, or in-house initiatives. Why this change in so short period of time, so would I be wrong to assume that Banks is perceiving a more like a little of this scenario for top-line growth? It will balance or offset as weaker than expected performance of revenues and deliver a high profitability. They are shifting their minds and starting to pick cost but -- but my more important than this, are you seeing this movement in your competitor too? Or only Itau shifting this strategy from products and growth to cost management. After this 4 months of the year. Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Hi, --. Thanks for your question. Yes it's true and we started to be much more aggressive in dealing with costs. Once we realized that the economy would not vote as we had expected when we supplied the guidance. I mean as I mentioned already and in the our expectation for GDP growth was cut by half but it in from 2.5% to 1.3% and this is what let us to be much more active on cost control than they initially. When you -- we don't really talk about competitors, yes. So even for your competition. But I should just observed and I mean that our competitors, main competitors guidance forecasts, is already very low. Ours was the highest guidance for all cost.

Q - Analyst

Okay. Thank you very much, Candido.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thank you.

Operator

The next question comes from Jason Mollin Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you. Just a quick follow-up on the comment that the outlook for the economy be is positive getting a pension reform in the second half of the year. What is the downside risk if we don't get this pension reform? what is the Outlook? How is Itau Unibanco preparing for this? What could that scenario look like? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks, Jason. The scenario is not good. So if the pension reform does not get approved, we will have the relation public data with GDP, it will keep on increasing this will cast doubts on the stability up inflation probably interest rates, will have to rise, we may see some pressure on the exchange rate. Also do also due to that. I mean the level of confidence as a whole in the economy is going to drop. And fortunately this is not a scenario, we are unaccustomed to. We have lived with this scenario very frequently in the past and we know what to do in this situation. So I just hope and expect that we will not have to use this tool kit at this time.

Q - Jason Mollin {BIO 1888181 <GO>}

Thank you very much.

Operator

Next questions Carlos Gomez, HSBC

Q - Carlos Goldman

Thank you and good morning. I'm not going to ask you about the current business for a change. My 2 questions are. Number one, on the tax rate and your tax rate is now up 32% our calculation of your peers are at 30%, 29%. Part of it obviously has to do with your international operations. But is there anything more structural or is there something temporary and do we expect to convert with your peers at some point.

And the second refers to the guidance but in a different way. I'm actually surprised that you have reduced your NII guidance by only 4.5%. And when I look at your economic forecast, 6 months ago you were expecting selic at 80% for this year. 3 months ago you were expecting 6.5%. Now you expect 5.75% and it seems to us that what you expect your NII to do has not really moved a lot in line with interest rate. We know that you are already being sensitive. But still, the impacts in quite minor. Could you comment on that? Thank you.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Thanks Carlos. I'll comment on your second question and then I will ask Alexsandro Broedel to comment on tax rate issue. You are right when you observe that we had a Selic rate extra, and I must just point out that it's end of the year Selic rate. But we had an end of the year Selic rate at 8.5% at our first forecast and then right now we have 5.75 and in the middle we have 6.5%.

What changed is I am not in the economic team making, the economic forecast. But as I understand from the economic team. What changes the perception of, when the pension reform would be approved. We started the year the end of last year we believe the pension reform could be approved early this year. If it were the case then we expect that economic pickup derived from that, from the levels we had and this will drive the need for higher interest rates in order to keep inflation under control. As we've seen inflation as well behaved now in recent months, it has shown a couple of higher indices but our economic team believes it's well and under the control.

And the expectations for the pension reform have moved to the second half of the year. And it's widely expected in the market now that, if it were not for the fiscal weakness, structural weakness, of the Brazil, interest rates could be lower. This scenario has been building it is consensus has been building in the economy. So now the expectation is that immediately after the approval of the reform there could or there should be a drop in the Selic rate. Afterwards, as the plan unfolds and the economy starts growing and so on, the question of raising interest rates may come again into place. But the important I mean why does is the effect in our NII with being really limited is because in both cases be it in when it was 8.5% be it now and it's was 5.75%. We are only referring maybe to the last couple of months in the year. So the effect of this is rather limited. I pass to Broedel now.

A - Alexsandro Broedel {BIO 17663830 <GO>}

Carlos, too many reasons to reconcile our effective tax rate with the one the different competitor of that you mentioned. The first one is goodwill amortization. We -- our level of goodwill amortization at the moment is much lower than this case that is mentioned, so that affects our effective tax rate. The second reason is ROE, so higher ROE, higher effective tax rate because the benefit of interest on capital is pretty much fixed over the year because that depend on the amount of your equity and the amount of the delay to the price of the book value of equity. So these are the 2 main reasons that reconcile our number with that.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you. And second follow-up on the interest. You now expect rates to be lower than in the past with respect to higher pricing focused during the last amortization of your NII for 2020?

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Lower interest rate in 2000. Yes. Our lower interest rate has been. Yes, I mean if you look at the chart will show in page. Let's see if I'm here on page 5. In page 5, we show our NII How it has evolved , how the Selic rate dropped from 10.9% to here it's 6.4% because it's the Interbank rate. So it has dropped 4.5 points and as you see from our NII level, it has kept well to the amount 12% or high 11%, so the yes, I mean it's not an interest rate, it does not affect our NII, but it affects in different manner and somehow, quite often compensating manners. Volumes tend to grow there are many compensating factors and this is what explains that our NII virtually unchanged as the interest rates, suffered this drop which we have seen here. I expect it to remain the same way should the rates drop for the next year.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you very much.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

You're welcome, Carlos.

Operator

This concludes today's question-and-answer session. Mr.Candido Bracher, at this time, you may proceed with your closing statement.

A - Candido Botelho Bracher {BIO 3158644 <GO>}

Will, just to thank everybody for your attention and your interest in our results and the very good questions. Thank you.

Operator

That does conclude our Itau Unibanco Holding Earnings Conference for today. Thank you very much for your participation. We would like to invite you to join the conference report to be at 11:30. You may now disconnect.