Q2 2012 Earnings Call

Company Participants

- Alfredo Saenz, CEO
- Jose Antonio Alvarez, CFO
- Unidentified Speaker, Unknown

Presentation

Alfredo Saenz {BIO 1422535 <GO>}

Good morning. We're going to begin the presentation of the results for the first half of the year. And as we usually do, I will be talking about the main aspects for the first half and the results of the Group. And then Jose Antonio Alvarez will look at the business areas in more detail. And lastly, I will close with my conclusions.

The first thing that I should point out is that the economic context continues to be very difficult, with a great deal of uncertainty in the global deterioration of confidence. By areas, renewed tensions in Europe. And the market's lack of confidence, reflected in sharp increase in the risk premiums of peripheral countries, such as Spain and Italy. The US, though, performed better. Its economy is growing moderately. And Latin America remains strong, despite the international context.

In this context, our strategy is to strengthen the balance sheet, supported by our capacity to generate earnings. The three key elements of the quarter are, first, the strength of the upper part of the income statement. Pre-provision profit was EUR12.5 billion, after again surpassing EUR6.2 billion in the quarter.

Second, in the quarter we made provisions for real estate in Spain of EUR2.78 billion. This lifted coverage to 46% of the total problematic real estate balances. And represented more than 70% of the requirement of the Royal Decree.

Third, we combined these provisions with a capital ratio above the 9% required under EBA criteria. And core capital BIS II ratio above 10%.

Fourth, we continued strengthening the balance sheet. In liquidity, we kept the Group's loan to deposit ratio at under 120%. And in Spain it was 112% after improving the commercial capture in the year. And we continue to compare very well in credit quality in the main areas where we operate.

Recurring profit for the first half was EUR3.008 billion in the first half of 2012. And EUR1.7 billion after provisions.

Next we're going to take a look at each one of these points in more detail.

The generation of results. The first aspects to point out are the results, where the Group maintained its strong capacity to generate recurring results. Pre-provision profit was EUR6.223 billion in the quarter. And EUR12.5 billion in the first half; 6% over the first half of 2011. And 10% above that of the second half. In other words, we are keeping up the excellent track record of this item, in which we are one of the leading Banks in the world.

In this slide we can see the positive performance. And we see that the performance is due to two drivers; first, the co-dynamics of revenue, which were higher than in the first and second half of 2011. And second, cost containment; costs are flat in the first half compared to the second half 2011.

The second thing to point out in the first half of the year is the significant effort made in real estate provisioning in Spain. The Group decided to allocate gross EUR2.78 billion; EUR1.923 billion net of taxes. One-third of this amount came from the capital gains obtained from the sale of the subsidiary in Colombia, EUR619 million; and two-thirds, in other words EUR1.923 billion, came from the quarter's ordinary profit, underscoring the Group's priority in strengthening the balance sheet.

In short, in the Second Quarter we posted ordinary profit of EUR1.404 billion, which coupled with capital gains amounted to EUR2.023 billion. Of this amount, EUR1.923 billion were allocated to provisions. Thus, accounting attributable profit for the Second Quarter of 2012 was EUR100 million.

These profits do not include the capital gains generated in the recent agreement to reinsure the portfolios of insurance companies in Spain and Portugal, as the operation was signed after the end of the quarter. They will be recorded in the second half of the year. And they will be assigned to real estate provisioning.

The third point is capital. The (third) in the quarter we combined the effort and provisioning with solid capital ratios. BIS II core capital ratio was 10.1%. And we exceeded the ratio of 9% required by the EBA for June, while our forecasts lead us to think that we will be above the various possible requirements for the end of the year. And this capital strength is not just at Group level; it is also seen in the various units. And most clearly in those units operating in countries where their banks needed State aid.

As we see in this slide and the next one, none of the Group's units have a capital shortfall. Starting in the UK, whose banking system has needed significant injections of capital, Santander UK not only needed no aid. But participated in the system's restructuring, acquiring banks with problems, which enabled this to improve its market position. And with a core capital of more than 12%.

Similar comments can be made for Portugal, where the rest of competitors needed to raise funds either from their shareholders via the issuing of contingent convertible securities, CoCos, or directly from the State to cover their capital shortfalls. And meet the Troika's requirements.

In the case of Santander Totta right from the onset the ratios were much higher than those required and, today, the core capital ratio of 11.4% is clearly above the 10% required by the end of the year.

Lastly Spain, where the financial system has entered the financial assistance program and is in a process of recapitalization. Santander Parent Bank has a core capital of 10.2%. Furthermore, the top-down analysis conducted by two independent consultancies, Santander would not need capital. This is particularly important for three reasons.

First, because the adverse scenario for the next three years used for the analysis is much tougher than that in similar exercises in other countries. And moreover is on top of the strong adjustments in Spain's macroeconomic variables that have been already taking place.

Second, because even in this scenario, which is giving a 1% probability, the Group would have a capital ratio of around 9%; and third, because it ratifies and reinforces the IMF conclusions on Santander in its recent analysis of Spanish banks. Lastly. And within the classification established for the financial assistance, Santander would be in group zero of the memorandum of understanding, the one for banks with no capital shortfall.

With regards to liquidity, the Group remains in a solid liquidity position, basically through two drivers. On the one hand, deleveraging in some markets, mainly Spain and Portugal, where we have reduced the commercial gap by EUR12 billion in this first half of the year; partly from the fall in lending and partly from growth in deposits, mainly in the retail network.

On the other hand, we maintain a very conservative policy in issuance, backed by our wide and diversified access to wholesale markets through 10 units with issuing capacity, which include the parent bank and the Bank's main subsidiaries. This enables us to issue more than EUR16 billion medium and long term, via the UK, Latin America. And Spain, placing in the market EUR9.4 billion in securitizations.

And this situation is reflected in the loan to deposit ratio, which remains at below 120% which, remember, was around 150% at the start of the crisis. And we have a medium and long-term financing ratio of 115%.

If we talk about credit quality, the Group continues to manage risk very actively. As the slide shows, we compare well with the average of the financial systems in the main countries in which we operate; in other words, Spain, the UK. And Latin America.

The Group's NPL ratio is 4.11%, 13 basis points higher than in March. And maintaining the small rise of previous quarters. This increase is basically due to the evolution of Spain and Portugal, which maintain the trend mentioned in recent presentations. Also Brazil, in line with the changes in the market in the last few quarters, increased its ratio.

Santander Consumer Finance on the other hand reduced its ratio in the quarter to below 4%, an excellent figure for this business. Sovereign Bank improved for the tenth straight quarter. And the UK and the rest of Latin America remained stable. The small rise in Latin America, excluding Brazil, is mainly due to the mathematical impact of the exit of Colombia in the quarter, whose ratio was below 1%.

With regards to coverage, the Group's coverage rose by 3 points in the quarter to 65%. This improvement was largely due to the rise of 7 points in Spain after the provisioning made in the quarter. And also to improvements at Santander Consumer Finance, SCF. And Sovereign Bank to 111% and 113% respectively. Stability in the UK and Latin America's coverage remained high at around 90%.

If you look at the Group's results, the slide shows the accounting changes and after eliminating the net impact of the perimeter and exchange rate effects, which are very reduced in the first half. There are two main points here; first, the strength of the upper part of the income statement, with a 7.3% rise in pre-provision profit on a like-for-like basis. And without the exchange rate impact over the first half of 2011.

And second, that this did not seep through to the bottom line because of three factors; greater loan-loss provision, partly due to more specific provisions in some units and the release of generic provisions in the first half of 2011; the negative impact of the rise in minority interest after placing part of the capital of subsidiaries in Chile and Brazil; and lastly, the impact of the real estate provisioning in the quarter.

If we talk about revenues now; excluding the exchange rate impact, we can see that the fees, net interest income and insurance activity income, all these increased in all cases. The basic revenues grew 16% in Latin America after rising for the ninth quarter. Basic revenue also grow 16% in Latin America. But the main driver was net interest income and was 9% higher than in the first half 2011.

Also in Continental Europe we see a recovery in the last few quarters due to the evolution of retail banks. Other revenues, which count for 8% of the total, these remained mainly stable, because of the reduced trading gains and the smaller contribution of income by the equity accounted method.

With regards to expenses, well, all units registered almost zero or negative growth in expenses over the First Quarter, maintaining the slowdown seen in previous quarters. The moderate rise over the first half of 2011 reflects the revision of collective wage agreements in some countries; investment in the commercial network and technology; and the impact of the incorporation of BZ WBK, the Polish bank, to the Group in April 2011.

And with regards to provisioning, the slide shows loan loss and other provisions made by the Group in the quarter. The upward trend in loan loss provisions continued, because of the phase of the cycle in Spain and Portugal. And the rise in Brazil. Brazil reflects the deterioration in credit quality in the system from lower than expected GDP growth.

We believe we'll see an improvement in provisions in the second half, given the positive evolution of irregular ones at less than 90 days, which have improved 40 basis points in the Second Quarter. And the measures taken by the government to jump start the economy. In addition. And after the real estate provisioning made in the recent quarters, the Group has met more than 70% of the requirements of the Royal Decree, including the capital buffer.

More specifically, the effort made in the First Quarter 2012 enabled us to raise coverage for real estate exposure in Spain significantly; in doubtful loans, 44% from 33% in March; and sub-standard to 42% from 16% in March; and in foreclosures to 50% from 48% in March. This gives coverage for all problematic real estate assets of 46%, much higher than in March.

Coverage of all the real estate exposure, in other words including outstanding risk, is 39% considering the capital buffer. And is expected to reach around 50% once the requirements of the Royal Decree are met. I remind you that these figures do not include the fund to be established from the capital gains of the insurance operation.

I now hand over to Jose Antonio Alvarez, who will look at the different business units.

Jose Antonio Alvarez {BIO 19692884 <GO>}

Good morning. As the CEO said, I will now be talking about the different business areas.

First of all, I'd like to note our geographic diversification in the Bank. And the good balance that has been reached between the mature and emerging markets. As we can see in the graph, 54% of profits come from emerging markets, with Brazil providing 26% and Poland, as our last unit, representing 4%. With regards to mature markets, the contribution is well balanced; Spain contributes 14%, the UK 13% and the US 10%.

If we look at it by unit. And starting with Continental Europe, I would say that the income statement reflects the difficult environment in which business is being developed, sluggish growth, deleveraging in the main economies in which we operate. And low interest rates. This probably is the most determining factor.

The profit of the geographical area in the first half was EUR1.211 billion, lower than in the same period of 2011. The comparison is affected by the positive impact of the entry of the Polish unit, BZ WBK. And the negative one from the release of generic provisions of EUR300 million in the first half of 2011, which was not repeated in the first half of 2012.

Now, there are better trends though as we look at the Second Quarter over the First Quarter; basic revenues rose (16%) due to the net interest income. Of note was the recovery also in the commercial networks in Spain and Portugal. Expenses fell (1%) in all items. And provisions remain stable, with the exception of the extraordinary provisions that we make up the corporate center which fall (1%). Attributable profit increased for the Second Quarter running.

If we look at all the units, this trend is seen in most units. We can also see a fall over the first half of 2011. But a better trend in all items over the second half, mainly due to the recovery of revenues and flattening of provisions.

Let's look at each one of these units in more detail starting with the Santander Branch Network. And if we talk about activity we can say that there's been good growth in deposits. Deposits are going up at 15%; in terms of balances this reduces the relationship between loans and deposits by 20 points in one year.

In terms of results, basic revenues show a positive trend both year on year and quarter on quarter. Provisions also showed a flatter profile than in previous quarters. Because of a combination of all the factors, we have profit that has been growing since the Fourth Quarter of 2011. So in short, I would say that in an environment of deleveraging we are recovering some revenue, flat cost and stabilized provisions. So a certain stabilization.

If we look at Banesto, perhaps the most important differentiating aspect here is the different pricing policy on liabilities, which means that the activity is different. Reduction in the commercial gap of over EUR4.5 billion in 12 months. And so the loan to deposit ratio improved. Then there's also a recovery of the basic revenues and profits in the last quarter.

Expenses are holding at 1% and the year-on-year comparison is affected by the release of provisions in the first half of 2011. Tomorrow the CEO of Banesto will explain in further detail all these figures. I just wanted to point out to the main elements.

If we look at Spain as a whole. And here I'm talking about the Santander Branch Network and Banesto plus the Wholesale business in Spain, Santander Consumer Spain and Banif, in other words all the activities that the Bank carries out in Spain. Total gross lending stood at EUR217 billion. It's grown; later on we'll see the result. 50% of that lending is to companies with no real estate purpose and 25% are mortgages.

Deposits total EUR187 billion, including EUR10 billion of retail commercial papers. Of this EUR82 billion are demand deposits. The difference between those two deposits has fallen by EUR10 billion in the first half, putting us in the run rate to cover all the year's maturities. This was because of a fall of lending. But also the rise in deposits. We are seeing strong growth in retail deposits offset by some outflows in institutional deposits, as a result of automatic triggers following rating downgrades.

If we look at the lending portfolio in Spain in further detail, the first thing that I should point out is that the sharp fall in loans with a real estate purpose. And deleveraging of individual customers, was maintained in the quarter and the deleveraging of individual loans. On the contrary, companies seem to be more stable. And the public administrations are increasing, for payment to suppliers, EUR4 billion.

Non-performing loans, well the real estate sector's NPL ratio rose to almost 40%, because of the double impact of the increase as a numerator and the sharp fall in the denominator from the decline in balances. This fully explains the rise in NPLs in Spain as the rest of segment remains stable after the rise of around 0.5percentage point in 2011. So Santander's credit quality remains much better than the sectors in Spain as the CEO mentioned.

And now if we look at the gross NPL entries, before recoveries of the non-real estate sectors, you can see some stability. Here we have the figure with the first half of 2008 as base line. So pre-crisis. Net entries in consumer finance and cards are clearly below the levels of the first half of 2008, basically half. And in mortgages after the peak of 2009 where levels gross net entries, which is similar. In businesses we see a slight rise, because of the recessionary context with the gradient, which is rebased and it reflects the underlying economic crisis.

We move on to our real estate exposure. As we've explained, a strong drop in the quarter. The total of loan plus foreclosures dropped by EUR1.8 billion in the quarter, accelerating the pace of decline of the previous three years.

Also, in this decline there is something that had not happened before, which is the volume of foreclosed assets. We had announced it in our presentations in previous quarters that after two quarters, in which volume had remained flat, we are beginning to see the first-time decline. And we think that this is a trend that will accentuate in the coming quarters. And that there will be additional fall in the volume of our foreclosed assets.

So, in summary, our management is very focused on reducing our real estate exposure and, as our CEO has explained, to increase our coverage, which is currently at a level of about 50%.

Moving on to Portugal the country -- the macroeconomic context is still difficult. The financial adjustment programs agreed with the EU continue. And this impacts the volumes and the results of the Bank.

In volumes the trends are fairly similar to what we saw in Spain. Deleveraging continues. Loans fell by 7%; deposits grew by 7%. So we have a significant deleveraging. Income performed well, in part due to less competition for deposits in the market. The cost of deposits fell.

And operating costs went down 4%. 46 branches were closed in the year and that has reduced our costs. And we have reinforced our provisions from the results of the tender offer we made in the First Quarter. Overall, profit was EUR71 million. So, in short, the Santander continues to deleverage. Revenues are recovering; profits have remained relatively stable; and, overall, NPL has risen a little. We are moderately optimistic.

Santander Consumer Finance in Continental Europe, because the results for the UK are incorporated into the UK. And those in the US are incorporated into the US business, have had a highly recurring profit in a very difficult environment. Automobile sales, which represent about 65% of our Consumer Finance activity; new car sales have fallen 7% in our footprint. Several countries are in recession.

The two elements which boosted our profits, our business model, we have continued to increase volumes due to the (respecification) by countries, by products. And also because of the brand agreements with manufacturers which have enabled us to increase our market share in new cars in several countries. So our front book is still growing greatly above the industry averages. And so we're gaining market share.

And risks are very much under control with a high coverage of 111%. And NPL dropping. So that, as a consequence, our profit has risen by 4% year on year. So in summary this is a business which is generating solid profit in a not very favorable environment.

And finally, I'll speak about Poland, substantially different environment, good economic growth; good growth in loans and deposits, double-digit growth in both cases. NPL ratio falling to 4.9%, that's 1.5 points lower than the year before. As for volumes, both loans and deposits, as I've said, are growing significantly and consistently, both to individuals and to businesses.

As for our results, if we look at this semester and compare it with the second half of 2011, we don't compared with the first half of 2011, because it wasn't within the Group's perimeter at that time. In the comparison between this semester and the previous one, revenues increased 4%, fuelled by net interest income, mostly because of greater spreads on deposits and growing volume. Expenses remained flat; pre-provision profit and attributable profit by just a two-digit growth.

In 2012, with a better environment than in other markets, we think we'll be able to continue to grow our volumes at this rate. And also our highest priority in Poland will be, once we have the regulatory permit, to merge BZ WBK with Kredyt Bank once we have the regulatory approval, which we are currently obtaining.

In the UK, in very difficult macro-economic and regulatory environment, there are two trends, falling volumes and very low interest rates. And these are significantly impacting our ability to generate revenues. The more important negative factors though are the cost of funding, which has risen in a very competitive market. And wholesale funding has also become more expensive.

As for lending, the spreads on new loans in general in the last quarters have been improving. And so the effect on revenues is more to do with falling volumes and rising costs of wholesale funding. Net this fall in revenue, I think, we're at levels which are close to minimum. And we hope to see this trend revert towards Q3/Q4 this year.

As for costs, they've gone down in real terms. And provisions have remained flat. Credit quality is still good, still stable within the levels of high quality that we have consistently maintained in our book in the UK.

In total, attributable profit was 41% higher. You have to remember that last year in the second semester we had to establish the PPI provision, which is why there's been this increase, 41%. In summary, the fall in revenues has impacted our profit in a difficult market environment which we expect to improve towards the end of this year.

Brazil. I'd say that this is a completely different environment with strong volumes, lending growing at 18% boosted by mortgages, consumer finance and SMEs. Deposits growing at 6% in an economic environment which is not or has not, in the last three quarters, been quite so favorable, with economic growth relatively slow.

Profit in Brazil was $1.49 billion. The top part of our P&L very solid, basic revenues growing at 17% due to volume growth and spreads remaining relatively stable.

Costs growing at a slower pace, although there has been a significant increase, because last year we opened 100 new branches -- in the last 12 months we've opened 100 new branches. And there's also been a rise in wages as a result of the latest agreements signed in the second half of 2011.

Net interest income was 20% higher. This growth in the upper part of our income statements which feeds through to the profit only to a lesser extent because of rising NPLs in the country across the board for the whole industry in an economic environment which, for Brazil, was relatively weak.

In our case, our loan book has been -- has significant component of cards and consumer finance. So our rising NPLs in the industry affect us sooner. But now we believe that the full 90 days' default is falling. So we are relatively optimistic with regards to an improvement in provisions in the second half of the year. And this will also be accompanied by economic recovery. It seems that the country in the year will be growing at about 2% when in the first two quarters it was basically at zero.

And, in summary, I think the Bank is now moving forward successfully in its business performance. The rise in NPLs we believe to be temporary and strongly connected to the economy, which we expect will improve in the coming quarters, as will our profit.

In Mexico business has continued to register high double-digit growth. We've gained market share in loans to SMEs, cards, mortgages and really across the board, time deposits, demand deposits. We're gaining market share significantly in all these segments. Our brand continues to grow in the market.

Basic revenues rose by 20% fueled by net interest income and fees, a very good performance there. Lower trading gains, because in the first half of 2011 we had capital gains from the sale of Visa and MasterCard shares. Increasing costs is strongly linked to growing volumes, more sales staff and rentals after sale and leaseback of 220 branches a few months ago.

Provisions rose in line with lending, 17%, with low risk premium falling. NPL rate was 1.64%, down 81 basis points in the year and coverage was at 183%. So profit amounted to EUR556 million 18% higher in local currencies. So, in short, good business and profit performance, which we believe will continue in the coming quarters.

In Chile we've had good volumes, particularly in deposits, up 15%. In loans less, growth because we've been focusing on profitability and there are some significant market segments in Chile where spreads are very low. And so where we've not been aggressive we've been significantly more selective and we prefer to focus on high income and not so much in other segments, like mortgages, where spreads are relatively low.

Basic revenues grew 6% affected by the sharp fall in inflation, because there's a significant part of our balance that pays inflation plus spread. So the sharp drop in inflation has had a negative impact, as had the regulatory framework on fee income. Also, in Chile there's been a higher cost of lending although we anticipated that with the provisions that the rest of our peers are having to make. So in short, lower inflation, tougher regulations and high provisions have affected attributable profit before minority interests. I'm speaking about the Bank overall. After minority interests, of course, this is amplified.

Looking ahead, we envisage some positive aspects for our income statement. Lending growing, our costs decelerating and stable provisions and, therefore, lower cost of credit overall. On the other hand, there are still some significant regulatory impacts that might affect us, such as a cap on rates and some risk of lower inflation.

Details of the other Latin American countries; Argentina, profit rose 7%, reduced by the higher tax rate of 33%. Profit before taxes was up 19% but with the higher tax rate net profit rose only 7%. Double-digit growth in profit in Puerto Rico and Peru; and Uruguay's profit more than doubled although, of course, it was a very low level in the first half of 2011. And BPI's business has also improved.

Finally the last geography, the US, beginning with Sovereign Bank, the (top) brought in $362 million; some growth, single digit, in loans and deposits, low single-digit growth due to conditions in the American market, the same as or lower, our peers' case.

Profits were flat, registering a fall in net interest income, because of lower interest rates and we also have had some run-offs. And provisions fell sharply due to an excellent evolution of NPLs and coverage. Fee income fell due to regulatory effects and coverage is already at a very high level.

As for Santander Consumer US, contribution of $229 million in the quarter, good growth; the auto market has been performing quite well in the US. Lending grew 16% with better spreads on new loans and profit, two factors, basically two, the release of provisions that was made in the First Quarter of 2011 and a perimeter effect.

If we look at the red part of the slide, that's attributable profit for the Group. And after selling part it remains at $100-and-some million in the quarter, showing the excellent performance of this business unit. So, overall, the total profit generated by the US was $591 million in the semester.

And finally corporate activities, not much change versus the previous year. Net interest income has remained almost flat, identical to the first half of last year; lower volume of wholesales issues offsetting the higher cost of credit.

As for trading gains, the impact is due to our exchange rate hedges. As you know, we have an active hedging policy and some impacts due to the impact of exchange rates on dividends and portfolio valuations. But it's basically exchange rate effect. And the bottom line was affected by lower recovery of taxes in 2012.

Additionally, our profit was affected by the recording in this area of capital gains and extraordinary provisions, as I explained at the beginning of the presentation, the EUR1.34 billion that our CEO mentioned, who will now take the floor to close this presentation.

Alfredo Saenz {BIO 1422535 <GO>}

Okay, to conclude we are going to hear some general comments and also an outlook for the rest of the year, for the second trimester.

In the next two quarters Santander will continue reinforce its balance sheet by adapting its management and strategies in each of the markets to growth and conditions in each of them.

In Spain and Portugal we face a strong recession and high volatility and, therefore, our priorities will continue to be strengthening our balance sheet and provisioning our real estate exposure. And this strength will remain key, in order to take advantage of the opportunities that the markets might afford to gain profitable market share.

In the rest of Continental Europe we expect to maintain the highly recurrent results we have seen in recent quarters.

In Santander Consumer Finance, bolstered by a business model, which is difficult to replicate due to -- by our competitors, because of its product and country diversification and our agreement and alliances with manufacturers.

In Poland we will take advantage of macroeconomic contexts and low banking penetration to achieve the profit levels we have issued as guidance, while we proceed with the merger with Kredyt Bank.

In the UK we are almost finished absorbing the negative effect that -- on our net interest income. When these factors are stabilized, we'll be able to see the results of the improvements achieved in our different businesses, both our individual and business areas, which we will continue to reinforce.

In Latin America we will continue to see revenues grow strongly through volume growth and better spread management.

In Brazil and Chile we have seen high provisions which are, however, stabilizing or falling. And, as a result, we will be able to see the strength of the upper part of our income statement feed through to the bottom line.

In Mexico we will maintain the current trends and work to strengthen our brands, opening new branches that will enable us to continue to gain profitable market share.

And finally, in the US we will continue to invest in our retail network in one of the areas with most economic potential in the country. We are completing the IT integration, as well as integrating the new sales model in our branches. And this will give a new push to business and product development in areas such as GBM, Global Banking and Markets. And Credit Cards amongst others, where we have an excellent outlook.

So in short, Santander will keep working to strengthen its ability to generate recurrent profit. Thank you.

Questions And Answers

A - Unidentified Speaker

Good morning. As usual, we will now answer questions coming in through various channels. First, we'll begin with the questions that have been coming in through our website. I'll divide it into themes. So we can answer as much questions as possible.

On the first set of questions about strategy and regulation, there are several questions about Mexican IPO, our vision and our plans. And I'll just explain, because the questions come up two or three times, that we maintain what we've said in previous quarters that the IPO is in our plans. And that we will provide more details as the months go by. No change with regards to what we announced in previous quarters.

There's another question that has come in several times, the capital gains on the insurance deal that we reported to the CNMV as a relevant event a few days ago; that's part of the results we've posted. And the answer is no, those capital gains have just been generated and, therefore, they will be charged to the current quarter.

Then there's a question from Juan Pablo Lopez from Espirito Santo. And Carlos Peixoto from BPI. What do we expect from the Oliver Wyman stress tests, the evaluators and the process, which begins from now. And whether our policy or our current view is to take advantage of the situation to acquire market share? And they say in Spain. But I suppose they mean in general.

A - Alfredo Saenz {BIO 1422535 <GO>}

As you know, we are now all undergoing the bottom-up stress test, which has different stages. And which will conclude at the end of September. What do we expect? Well we'd expect nothing different or very different from the results of the top-down stress test.

In our own particular case in Santander's case, we really expect no difference. In the top-down process, we were classified as group zero, that is as banks which require no capital injections. And in the bottom-up process, which has begun, we now understand the process, it will simply confirm that Santander requires no extra capital. And will therefore remain in group zero. And not be affected by the MOU.

And, of course, that does afford us certain opportunities for the future. We could take advantage of various types of opportunities. We can grow organically. We're already noticing that, as we've reported. And that is part of the reason for the excellent results we are obtaining in Spain. In the top part of our income statement in net interest income there has been a flight to quality. And we have gained market share profitably in the last few months. And we expect that to continue. So this is an affect which is bolstering our organic growth.

As for inorganic growth opportunities, as we've always said, we assess all opportunities; we take part in all auctions and sales processes; we analyze the conditions and the opportunities; and if we see an opportunity that makes sense, we explore it. But we will continue to assess any opportunities that develop and decide accordingly.

A - Unidentified Speaker

There's a second set of questions about dividends and remuneration after Telefonica's announcement yesterday. Question from Santiago Lopez, Exane. And (Stanislas Negone) from BNP Paribas. And Daragh Quinn, Nomura, with regards to our intentions versus pay out and dividends. Are we going to modify our dividend policies both for cash and script dividends? As for dividends and for remuneration, do we think that we should limit remuneration to board members or executives, would that be a positive step, or would we do things similar to Telefonica?

A - Alfredo Saenz {BIO 1422535 <GO>}

Our dividend policy has been set and reported to the market, it was reported expressly in the last results presentation. And so the only thing I will add now is that I can confirm that we will maintain our current pay out policy. There's no change.

As for remuneration to executives and Board Members, this is an issue that we are reviewing and will be discussing soon. And we will probably follow the approach followed by other companies. But it's not something that I can be specific about yet, because it has to be decided by the Board in due course.

A - Unidentified Speaker

As for asset sales or divestments, several questions from Britta Schmidt in Autonomous. And Daragh Quinn from Nomura. First about real estate asserts, are we interested in selling a package of real estate or selling larger chunks of property, instead of the individual property sales we're carrying out? Has demand risen? I suppose that means for real estate assets in Spain. And are we willing to offer bigger discounts on our sale price. And how large? Would we be interested in selling to a bad bank. And what do we think about the bad bank? That's about real estate.

And Marta Romero from Keefe is asking about Banesto, will it continue to trade, buy it, sell it, what sense does it make?

A - Alfredo Saenz {BIO 1422535 <GO>}

If you look at the numbers you will see in Q2 property sales were larger than entries for the first time since the turning point this quarter. Last quarter, as you know, it was almost flat with a very slight rise. And we announced already that the following quarter probably. But of course now it's a fact, sales would exceed new entries by EUR200 million-and-some. So that's the first significant breakthrough for closed assets no longer growing.

Second, sales in Q2 have been very good; we've sold EUR1,300-and-some-million in the quarter. And that's also a milestone, because we sold more than almost in the whole of 2011. So we've been very successful with our sales strategy.

We have no problem with considering sales of individual properties, or sets, or chunks, of property, it depends on the offers and prices. Would we be willing to sell packages or chunks of assets? The answer is yes, as long as the price is right.

What sale price are we obtaining? Discounts between 35% and 45%. So similar to the level of provisions we have. And, as we've explained other quarters, these prices will probably tend to fall slightly as a consequence of pressures in the market.

As for the bad bank, as you know. And as you will have read in the MOU, that is a possibility that is offered to those banks that need public finance. That is not open to the banks that are not in that position. So it's not anything that will provide any benefit for us. It's an internal decision for us and for the three other banks that are in group zero.

And for the banks that are in group three and are in the comfortable position, the choice to go for the bad bank is an internal organizational structural decision of what would best suit the management of these assets; to split them into an independent business or to keep them within the Group?

That is purely a strategic and structural decision for us. And, in our case specifically, we have decided not to establish a separate business formally. We have some subsidiaries that were really about real estate retail, Altamira and Mesena and Banesto and Santander, which we've merged just for efficiency's sake. But we don't see for now any benefit in the establishment of a bad bank, for us, for now.

So unless there's any significant change, we will continue as we are managing our real estate assets internally ourselves, through a specialized unit, which is in charge of this area. And it does not really interfere in the run of business and which has been very effective, as you see from the numbers I've just given you.

As for Banesto, what are we going to do? Well, as we've said over and over; Banesto will not be sold and will not be merged. So there's really no change in our usual strategy with respect to Banesto.

A - Unidentified Speaker

With regard to the selling of assets, there's a question from Benjie Creelan. How much are we funding the clients when we sell them real estate assets?

A - Alfredo Saenz {BIO 1422535 <GO>}

It's about 50%. I think it's 56%, if I remember correctly, what is being funded through mortgages for the individuals who buy property from Santander.

A - Unidentified Speaker

There's a question from Espirito Santo and from Sergio Gamez from Merrill Lynch. How much is spending provisioning of the Royal Decrees?

A - Alfredo Saenz {BIO 1422535 <GO>}

I remind you that the total impact was EUR8.8 billion minus EUR2 billion for the capital buffer. And we already said that we have more than 70%. So that's more or less what we need to provision, the difference either charged to capital gains or charged against the P&L.

A - Unidentified Speaker

And there is another question also on the update of the timing of RBS.

A - Alfredo Saenz {BIO 1422535 <GO>}

But no change in there; 2013 is the year in which we hope to carry out this deal.

A - Unidentified Speaker

A question from Sergio Gamez and another from JPMorgan on the MOU; do you see any alternatives to lower the cost of sovereign debt? Do you see an additional LTRO? Do you think that the Spanish debt can be stabilized?

A - Alfredo Saenz {BIO 1422535 <GO>}

Of course, a very speculative question. So it's very difficult really to give you a quality opinion.

We are witnessing movements which I think have a certain significance to solve a problem. And we hope that these movements will bring about results. And we hope that the spread of the debt will be reduced. And we hope that the risk premium will fall. But, as I say, this is in the hands of politicians. So that's all I can say.

A - Unidentified Speaker

To finish with this area of questions, there's another question on real estate assets. But I think it's already been answered, on whether we expect to continue to sell assets in Spain in 2012; at what price; and what will be the impact of the discount?

A - Alfredo Saenz {BIO 1422535 <GO>}

We gave the discount. We said how much coverage we have for real estate assets. So, I think you can come up with a conclusion with regards to the impact on the income statement.

And yes, we want to continue to sell real estate assets in the second half of the year at similar prices as in the first half of the year.

A - Unidentified Speaker

With regards to the financial area, there are three or four basic concepts here. I'm going to try to divide the questions into these different concepts.

The first one is LTRO; the money that we have in LTRO; our appeal to the European Central Banks; size; utilization.

Number two is, therefore, ALCO and the weight of ALCOs in the financial spreads.

Number three, sovereign debt; breaking down the sovereign debt.

These are the three main subjects. We have several analysts asking questions on these things.

A series of analysts have asked about the financial margin, net interest income, impact, etc.

A - Alfredo Saenz {BIO 1422535 <GO>}

Let me try to elaborate on the three that you asked about ECB, size, utilization. Well, in the first half of the year, what we see is a difference with regards to previous quarters, which was the effect of the sovereign downgrade. And with correlation, one to one, the downgrade in the Bank's rating in the short-term rating more than the long-term rating.

So what we've seen since April were some downgrades and then the sovereign downgrades, which have had two or three impacts. They've had an impact on institutional deposits, which is not too relevant for us though. There are automatic triggers. Our Wholesale deposits are 3% or 4% of the Bank's deposits. But there is an impact there that there are automatic triggers in some of these deposits.

Then there's a second impact, which is more important for the use or non-use of the ECB, which has to do with the repo. The repo business, just to simplify things, is divided into three parts. We have a repo with bilateral, with counterparty clients; and we have repos through clearance houses; and then we have repos through the ECB.

What has happened in the first half of the year is that the derivative of the sovereign downgrade, the clearance has gone up 12%, 14%, 13% to 30%, which means that we are using ECB more to do the repo business. And this is a non-stable use; it's not comparable with our LTRO, which were two specific operations. This depends more on how the market is for bilaterals, what clearance houses are like and what the ECB is like at that moment. So depending on that, we use the ECB to discount public debt. From 60% to 80% is in bilaterals and 20% to 40% we can discount for the ECB, depending on the week.

The second thing that is also related to that is the ALCO. The ALCO as a proxy of the ALCOs you will find in portfolios available for sale. All the ALCOs are classified in portfolios available for sale. There are no portfolios to maturity.

Therefore, the figure of ALCOs in the balance sheet is slightly less than EUR100 million. It's relatively stable. I think it's EUR96 million/EUR98 million, out of which EUR68 billion, if I remember correctly, is sovereign debt. About EUR35 billion is Spanish sovereign debt, out of those EUR68 billion, which is the same figure that we had at the end of last year. And at the beginning of last year too. So it's a relatively stable figure.

The duration of these portfolios is very similar to what we assign to current accounts, 4.5 years.

A - Unidentified Speaker

There is also a question regarding the weight of the ALCOs in the financial margins.

A - Alfredo Saenz {BIO 1422535 <GO>}

The financial margin was EUR60 billion, the net interest income of the Bank. The ALCOs would be about 4%/5% of that. That's with regards to the net interest income.

In other countries, the sovereign debt, the second one in importance is Brazil, where we have about EUR11 billion and the others are relatively lower amounts. We have EUR35 billion in Spain; the European Union EUR12 billion, out of which EUR2 billion are Portugal; EUR4.5 billion the UK; EUR11 billion, Brazil; EUR3 billion, Mexico; EUR2, billion Chile; EUR2 billion, the US; and EUR2.3 billion, Poland. These are the holdings of sovereign debt that we have.

Have I left anything out?

A - Unidentified Speaker

Yes, just to go over the questions and to answer all parts of the question, there is a question from Juan Pablo Lopez from Espirito Santo on the mark-to-market. How do we think it's going to evolve, the balance of the debt?

And with regards to that, the impact of the valuation adjustments, what impact is that going to have BIS II and BIS III capital ratios? And basically those are all the questions regarding debt.

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, the mark-to-market, the net one is about EUR2 billion negative, the whole portfolio. And the balance, I said is relatively stable. The balance in the future of that, it will depend on the performance of current accounts and the hedging needs. Therefore, I think it will remain relatively stable.

The impact of Basel II, no impact; and in Basel III, it seems that there might be an impact. But it's still too soon to tell.

A - Unidentified Speaker

Net interest income, (inaudible) and Britta Schmidt from Autonomous ask about the net interest income, first of all, in general by area and then by areas. The Spanish one is going up but there are no questions about this from other analysts.

The increase of the net interest income in Spain compared to the fall in other markets, what is the effect of the exchange rate?

And specifically on the net interest income at the Santander's network. And also at the corporate center.

A - Alfredo Saenz {BIO 1422535 <GO>}

For the net interest income, we would have to elaborate by country; in the Santander network, starting there, a good performance there in terms of the volume and a slight increase in our lending spread. It has been going up consistently.

With regard to other geographies, in the UK, it's due to the liabilities. And in Brazil, which is another important element, the net interest income is increasing, because of the volume, because the spreads remain stable but the volume is going up. In other countries, I don't know. In Poland, it's based on the volume, in Chile there is a certain deterioration of the spreads because of inflation. I think these are the main units.

A - Unidentified Speaker

Talking about capital now, Francisco Riquel is asking about the organic generation of capital until the end of the year.

A - Alfredo Saenz {BIO 1422535 <GO>}

No changes there; 10 basis points per quarter is more or less what we have been generating.

A - Unidentified Speaker

Francisco Riquel also asks about the capital buffer of the EBA, what is going happen with the sovereign buffer.

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, it's being discussed; it's being debated right now. And we'll have to wait for Q4 to learn more about that.

A - Unidentified Speaker

There is a question from Carlos Peixoto, why has the core capital fallen by EUR850 million in Q2?

A - Alfredo Saenz {BIO 1422535 <GO>}

That's, basically, because of the exchange rate. I remind you that differences by exchange rate affect the capital. On the other hand, risk-weighted assets also move along the same lines.

A - Unidentified Speaker

And (Frederic Tretch) asks about the levels of EBA in June. But we already said they are well above 9%.

There is a question from Ignacio Cerezo from Credit Suisse, what will be the impact from the capital and in the positioning of a downgrade of the Spanish rating of the sovereign bonds? Do you have any ideas on additional impacts of that on Santander?

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, we're just speculating here about a downgrade to a non-investment grade. Well, we would have to see what the performance of prices would be. Given the levels of the bonds right now, it isn't certain that a loss of investment grade -- well, we will have to see what the impact on the price would be in order to answer this question.

A - Unidentified Speaker

Juan Pablo Lopez from Espirito Santo asks about the, how are we going to use the DTAs? What will be the impact under Basel 3?

A - Alfredo Saenz {BIO 1422535 <GO>}

I remind you that there are two types of DTAs; those of temporary differences, which are judged against 10% or 15%. And that will be part of the impact of Basel 3 in January 2013, about 90 or 100 basis points; and the negative taxable income, that would be charged against -- well, the schedule, the timetable, is going to be 20 basis points a year. Half of that will be by DTA. So you can calculate the figures.

The reason why DTAs is generated, 40% comes from Brazil, 40% from Spain. Brazil, it's to deducted from provisions. And in Spain, it's the impact of the Royal Decrees. And we hope and we wait for profits to be generated to use them.

The figures are EUR18 billion in assets and EUR3 billion in liabilities. So net would be EUR14 billion to EUR15 billion.

A - Unidentified Speaker

And then with regard to positioning, they ask about the duration of the debt. Jose Antonio, if you'd like to elaborate?

Britta Schmidt asks about the unencumbered assets. And that's basically it for that question.

A - Jose Antonio Alvarez {BIO 19692884 <GO>}

Well, the debt is related to the duration of current accounts, three to four years, the unencumbered assets, I guess he's referring to mortgage-backed securities. It's 119%, the relationship between assets and the securities backed by assets that are issued.

A - Unidentified Speaker

Ignacio Cerezo from Credit Suisse asks about the capital gain of the liability management exercise in England, if it's EUR500 million. And how is that capital gain going to be used?

And Mario Lodos is asking about the provisions for the Royal Decrees. Why are these done at the corporate center?

A - Alfredo Saenz {BIO 1422535 <GO>}

Yes, in effect, there has been a capital gain of EUR500 million in the UK. For the time being, its use is pending. We will decide in the future what we do with that money. But for the time being, it has been used to reinforce the balance sheet. But at the end of the year, we will decide how we will use it.

A - Unidentified Speaker

Going into risks now, there are questions -- first of all, generic questions on the performance of risk and your outlook on the NPL rate. We have several questions regarding that. How do we see the performance of the NPL rate at a Group level. But also in the main geographies? And what has given rise to the worsening of debt everywhere? So would you like to talk about the general quality of risk?

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, in terms of the NPL rates, we have different situations depending on the market. And also different forecasts. In the second half of the year, the NPL rate went up in Spain. It went up also in Brazil and in Chile. So these are the three places where the NPL rate went up in Q2.

The reasons for these increases, I think, have been explained well. In Spain, I don't think I need to explain them, because it's quite obvious. In Brazil, we've had a first half of the year where the macro situation was worse. And therefore that made the NPL rate go up. And not only at Santander but throughout the system.

Private banks in Brazil have published, have posted their quarterly results a few days ago. And you will have seen that in all of them the NPL rate went up. And it went up for the same reasons they go up for us, too. So we're being affected like everyone else.

And they also go up in Chile for what Jose Antonio Alvarez explained, because of the specific situation in Chile with problem of (La Polar). We have a provision for that. And that is the explanation of where we are.

Now, looking forward, what do we expect with the NPL rate? Well, in Spain, it will continue to go up. I might make a mistake. But we think that from 5.9% in June, at the end of the year it might be 6.7%, more or less. So we will continue to see the NPL rate go up in Q3 and Q4.

And in Brazil, we think the NPL rate will stabilize. And we also hope to see provisions fall, because the cycle has changed. Economic growth is going to be better in Brazil in the second half than in the first half of the year. So in the future in Brazil, we expect an improvement of the situation. And our colleagues in Brazil share this view. They also expect that less provision will have to be made. And that the NPL rate will fall.

And in Chile, more or less the same thing; in Chile, looking forward, well, we already made some provisions. So we think that in the future, the sign is going to change there, too.

So basically, that is opinion on the NPL rate. Because in the other units and in the other countries, there is nothing to mention, because in all of them, the NPL rate is going down or remains flat, as in the UK. And we don't expect anything that might change that trend in the future.

A - Unidentified Speaker

More questions on risk; we have three questions. Well, the first one, you already more or less answered, on new entries, it's from Francisco Riquel from N+1 and other analysts ask about the level of entries. Is there any reason behind this increase in the NPL rate although you already more or less already answered that question?

And then the second question that refers specifically to Spain on the NPL rate in our real estate segment, more specifically in SMEs and individuals it improved somewhat in the Second Quarter. But what do you expect in the future?

And finally, also referred to Spain, Matteo Ramenghi and Juan Lopez from UBS and Espirito Santo can we talk about the restructured or refinanced loans, basically mortgages, in Spain? What levels are we talking about and how could that affect you?

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, I think that the presentation you will find on the web deals with the NPL rate in different groups; you will find that divided into the different segments. So what do we see in those graphs that, I repeat, you have in the presentation itself.

And what we see in those graphs is that for mortgages to individuals, the NPL rate remains stable; it is not growing. And that confirms what we've been saying, which is that mortgage loans to individuals are very resilient. And even more so when they are concentrated in segments of our populations as it is in the case of Santander which, obviously, is different to that of other institutions which might have a different makeup of their loan portfolio.

Also consumer loans, well, the NPL rate is going down. Consumer loans, that is very well-managed and the same thing can be said about the credit card.

In these three products for individuals which is consumer loans, mortgages and credit cards, for these three groups the NPL has fallen and we don't expect any change on that trend, because we can anticipate, we can predict. And we have fine-tuned our predictions. And, obviously, if we were to see growth or surprises in the future that would be an indication -- we would have an indication of that in previous months.

Now for corporate loans, the NPL rate is going up. It's not a strong upward trend; it's very mild but, certainly, the NPL rate has gone up. In the Second Quarter it did go up as compared to Q1.

And now if we put it all together and, of course, depending on the mix that gives you the final figure which in this quarter is slightly lower than last quarter's figure, because of the effect of individual customers. But if we divide it into parts, well, as what I said; in corporate loans fees are increasing slightly the NPL rate, although it's not too significant because of the weight of corporate loans. Where for corporate loans the NPL rate is very low and remains stable. And so this makes this ratio very favorable in that case.

The last part which was restructuring, I remind you that a year ago we rolled out a product of mortgages in Spain. And a volume of those who have decided to go for that product is about two million. And the bad debt is EUR7 billion to EUR8 billion ever since the beginning of the crisis.

A - Unidentified Speaker

With regards to Mexico, Marta Sanchez asks about provisions in Mexico. This increase for this quarter, is there a reason for that?

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, it was the First Quarter that went down. But the $130 million that we provisioned this quarter is that in line with the EUR125 million or $120 million that we had been doing in previous quarters, the risk premium is (1.5/1.7) so nothing extraordinary to point out there.

A - Unidentified Speaker

With regards to Brazil we have questions from Marta Sanchez, Juan Pablo Lopez and Ignacio Cerezo, also David Vaamonde has a question.

They ask about two things basically, one is the guidance; are we going to reach the target, what is our idea for a guidance? How do we see growth in the second half in Brazil, although you said something about that when you talked about provisions?

And the second question is quality in Brazil, when are we going to see the peak? How is that going to perform? But you also already mentioned that. But perhaps you would like to elaborate, because there are several questions on that.

A - Alfredo Saenz {BIO 1422535 <GO>}

Yes, I can say a bit more on that. In Brazil, clearly, the top part of the statement is really good, really good again, better than our competitors, which means that the Bank in terms of its vitality and its retail capabilities and business growth and so on, is performing really well.

Fee income clearly much better than the -- and fee income slightly worse than the competition; net interest income much better than the competition and, overall, very good although, as I said, the macroeconomic context in Brazil in the first semester was not very good. So in that -- with that excellent top part of the statement we think that the second half of the year will show much better results, because the top part of income statement will continue to grow strongly. It's only the bottom that will vary based on provisions.

And as I said earlier, what we expect in this second semester is for provisions to improve. We've been saying this because we have seen clear indications of this improvement in NPLs under 90 days in the Second Quarter. That is any irregular loans before 90 days have improved by almost 40 basis points versus Q1. And this kind of early warning system, which lets you know what will go into default the following quarter. And that is why we are saying that we expect less NPL entries in Q3 and, therefore, lower provisioning needs.

So that's basically the concept. And this, together with the improvement in the macroeconomic context, brings us to this positive outlook for the second semester Q3 and Q4.

A - Unidentified Speaker

Right and finish with risks, there's a couple of questions from Britta Schmidt from Autonomous who's asking do we expect any more PPI charges in the UK (both in) 2012 and the future?

A - Alfredo Saenz {BIO 1422535 <GO>}

We've said that we've provisioned everything for the PPI charge already. So we don't expect to have to provision any further than we have already.

And I am told that there have been several questions about the fully loaded Basel III effect on our capital. And again its 20 basis points approximately. These are estimates, because the regulation is not in force yet. But about 20 basis points, 15/20 basis points a year, of which I said three quarters could come from the DTA impact based on what we use up over the coming years.

A - Unidentified Speaker

As for the different business areas, specifically then the questions we've already answered starting with Spain, there's a question from Alex Pelteshki from ING, about the different trends and deposits in Santander and Banesto. How do we explain those different trends? And what do we think about volume growth in lending in the future?

A - Alfredo Saenz {BIO 1422535 <GO>}

(interpreted) Well, if we -- on deposits, it's true that in the first semester Santander grew in deposits much more than Banesto. But also much more than anyone else in the system as we said in the presentation, Q1 -- sorry, the first semester was very good for deposits for Santander, for different reasons which I won't repeat. But which have already reviewed.

In Banesto's case, there's basically a problem with policies. During Q1. And even in April until May, Banesto had a funding policy that was very focused on profitability and, therefore, reducing the cost of funding. And, as a consequence of that, it didn't grow very much. In fact, it lost volume in that context.

But since May, Banesto changed its policy. And in May and June, speaking about Q2 but actually also in July, already, Banesto has been growing its deposits strongly. But again, it's the consequence of a deliberate strategy to reduce its costs. And also a very comfortable liquidity position in Banesto's case, which required no special props. And so therefore it was a deliberate choice.

But now, its strategy has changed in May, as I've said. And starting in May we've begun to see a growth of almost EUR800 million a month, in the last three months.

A - Unidentified Speaker

Okay, as for lending, Matteo Ramenghi from UBS is asking about the growth in lending. There has been some growth in lending in the Santander network, a slight fall in the number of loans. But I suppose he actually means whether there's any public sector component in that growth, since at the Group level there's a EUR5 billion growth.

At the Group level in Spain, there's a EUR5 billion increase, can we explain the mix behind that growth in lending, especially public sector component?

And second, since we were talking about lending and deposits, Daragh Quinn is asking about the evolution of net interest income in Spain, in the Santander network, the reasons for that positive trend. And our outlook for the future. I think this last question has already been partly answered. But perhaps you could give us an outlook on the evolution of net interest income in Spain.

A - Alfredo Saenz {BIO 1422535 <GO>}

Can you ask the question again?

A - Unidentified Speaker

Two points, the first about the growth or rather the drop -- the total volume of loans has dropped. But there's been a rise in our exposure to the public sector. In part the growth in lending in part is due to the funding of suppliers for local government.

And the second was about net interest income, our outlook for the coming months or year, why it's been improving so much in the Santander network and in Spain, in general. And the second part of that question is our outlook for the coming quarters.

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, I think Jose Antonio Alvarez explained that a little while ago. I'm not sure what the question was. But in the Santander network, you have the effect of the growth in deposits plus the improving spreads on loans and, as a result, net interest income grows significantly. And in the rest of the year, the trend will continue in the same direction.

All right. And to finish Spain, a question about the rising loans to the public sector, yes, there is a EUR5 billion increase. And EUR4-and; a-bit billion and that's because of our program for local councils to pay their suppliers.

A - Unidentified Speaker

As for the UK, Alex Pelteshki from ING, Ignacio Cerezo from Credit Suisse. And Francisco Riquel from N+1 are asking about net interest income in Santander UK. Can we give some idea of why it's fallen? Is there any funding pressure? Can we give some outlook or a quarterly minimum. And how we expect it to evolve in the next quarters?

A - Alfredo Saenz {BIO 1422535 <GO>}

In the UK, net interest income in the Second Quarter fell. And it fell basically for two reasons. And I'll explain how we see it in a minute. It fell because there's been issues; issues that we are replacing short-term funding with long-term funding. And that's more expensive. And it's almost (GBP35 million) in the quarter for the UK. And a similar amount is the cost of deposits in the UK. There's been two factors; a very special (ISA) campaign, which always takes place in April, because it's a tax product. And there's always a lot of competition for that. And this year specifically, Santander UK was able to attract a lot of deposits through this campaign. And -- for some more aggressive price policy.

More aggressive for 2012, because in 2011, I won't say names. But there was another very big retail bank that was aggressive and made us lose market share. We have now regained market share by being a bit more aggressive in attracting deposits in the first semester of 2012. We had an ISA campaign which was very successful. And that has brought up the cost of deposits, GBP30 billion or GBP40 billion.

And looking ahead, now that I've explained recent developments, we feel that net interest income will probably continue to fall slightly in Q3. And will stabilize in Q4. So that's our outlook today; a higher cost of wholesale funding, because we've moved (GBP25 billion) from short term to medium term, plus what I said about the reason for that.

As for the bottom line, standard returned profit will be somewhere between Q2 and Q3. And will be improving somewhat in 2013. Around then, around an amount halfway between what we made in Q2 and in Q1. And that will be in the next two quarters more or less. And then after that it will grow again.

And if you remember what we said during our Investor Day in London in September, we spoke about that smile-shaped curve in the UK results. And that is the curve that we are seeing; a slight slump, initially. And then a turning point and a recovery after that. And that's what we're seeing and all I can tell you.

A - Unidentified Speaker

Now moving on to Brazil, there are three questions, all about net interest income. And the first is Juan Pablo Lopez from Espirito Santo, how do you think net interest income will evolve in the next quarters?

Also, Daragh Quinn from Nomura is asking whether we can give some kind of outlook for net interest income and revenues.

Second question for Brazil, Alex Pelteshki from ING is asking about volumes, can we give any guidance on growth for the rest of the year. And for the industry, in general?

And the third is whether there's any sort of strategy. Ignacio Cerezo from Credit Suisse, do we have any sort of hedging strategy for our Brazilian net interest income. And what term. And how do we see hedging our net interest income in Brazil?

A - Alfredo Saenz {BIO 1422535 <GO>}

Well, I think I've answered in quite a lot of detail about the Brazilian net interest income, past performance and outlook. Both fee income and net interest income. And I think I said also what provisions we'll do in the coming months. So, basically, I think I've already answered that question. And perhaps, Jose Antonio Alvarez could say something about our hedges.

A - Jose Antonio Alvarez {BIO 19692884 <GO>}

Of course, he's referring to an interest rate hedge. I said before that we had BRL15 billion in sovereign bonds and that's basically the hedge. And that covers the Bank against any fall in interest rates. And that's generally up to the maturity of those bonds, which tends to be about three years.

A - Unidentified Speaker

Okay, well, that concludes all the questions. I hope that we've answered all the questions that came in over the Internet. There are no questions over the phone. So again, thank you very much for your attention. And see you next quarter.