IR Call Transcript (Edited Version)
QNB Group Q2 2020 Results

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PRESENTATION

Operator

Good day, and welcome to the QNB Group Second Quarter 2020 Results Call. This call is being recorded. (Operator Instructions) At this time, I would like to turn the conference over to Elena Sanchez. Please go ahead, ma'am.

Elena Sanchez-Cabezudo ***EFG Hermes Holding S.A.E., Research Division - MD & Head of Financials Equity Research***

Thank you. Good morning, and good afternoon, everyone. This is Elena Sanchez. And on behalf of EFG Hermes, I would like to welcome you all to QNB Group's Second Quarter 2020 Results Conference Call. It is a pleasure to have with us in the call today Mr. Ramzi Mari, Group Chief Financial Officer; Ms. Noor Mohammad Al-Naimi, General Manager, Treasury; and Mr. Mark Abrahams, Assistant General Manager, Trading -- Treasury.

The call will begin with a presentation from management on the key highlights of the first half of 2020, and then we can pass on the call to Q&A. At this time, I would like to hand over the call to Mr. Mark Abrahams. Thank you.

Mark Abrahams ***Qatar National Bank (Q.P.S.C.) – Assistant General Manager, Trading - Treasury***

Thank you very much indeed, Elena, and good day, everybody. I will begin by giving an update on the actions taken by Qatar in light of COVID-19, followed by a brief overview of the macroeconomic environment in Qatar. Then I will cover QNB's semiannual financial results for the 6-months period ended 30th of June 2020. Finally, we will then open the floor to questions and answers.

Qatar has taken all necessary precautionary measures to protect society, population and economy from COVID-19. While the impact of the COVID-19 pandemic provides uncertainty, Qatar's economy has weathered the storm and activity is rebounding strongly as business resumes. We are now nearing the end of Phase 2 of a 4-phase plan for relaxing precautionary measures and are still seeing a continued decline in the number of new cases.

The government stimulus and support package of QAR 75 billion is equivalent to around 10% of nominal GDP. The support includes targeted measures to deferred taxes and fees, deferred loan payments, boost concessional financing for small and medium-sized enterprises, investments in the local equity market and also provide additional liquidity to the banking system. Qatar has demonstrated its ability to combine a prudent fiscal policy through containment of the growth of the public sector wage bill, sizable cuts in current expenditure, and enhancements in domestic revenue mobilization, along with a large public program of capital expenditure to be utilized at the Qatar National Vision 2030 and the 2022 FIFA World Cup. This program contributes to supporting the fundamentals for higher GDP potential over the medium and long term and enable diversification and stronger private sector growth.

Moving forward, additional private sector growth is expected as structural reforms are implemented, including ownership liberalization, the promotion of foreign direct investments, labor reforms, the permanent residency program and several initiatives to support SMEs as well as self-sufficiency in strategic sectors. Moreover, several other facilities to improve business environment procedures were launched at the various legislative, organizational and administrative levels. The creation of an investment promotion agency and a single window for establishing companies will facilitate faster registration and licensing of new businesses in Qatar.

Tailwinds for increasing hydrocarbon production will drive economic growth going forward. Six new LNG liquefaction trains are planned to increase Qatar's LNG production by 64% to 126 million tonnes per annum. Supporting the North Field expansion, Qatar has reserve capacity for over 100 new LNG carriers, worth over USD 19 Billion. Positive spillovers from increased hydrocarbon production will combine with diversification efforts and structural reforms to boost activity and spending in the manufacturing and service sectors.

The domestic capital market is evolving in a positive fashion, and the banking system remains resilient with significant growth, ample liquidity, high asset quality, and more-than-adequate levels of capitalization and robust profitability. Even in the case of global market, volatility and concerns persist with the development of the COVID-19 pandemic; the authorities here have announced that the Central Bank will provide additional liquidity to support the system, if necessary.

I will now move on to QNB's half-yearly financial results for the 6 months period ended 30 June 2020. Key financial results for the period are as follows: net profit was QAR 6.4 Billion or USD 1.8 Billion. Considering the global economic conditions, QNB Group, following its conservative approach towards building adequate reserves against potential loan losses, has opted to increase loans loss provisions by QAR 1.2 Billion, which will assist in prudently protecting the group from any adverse experiences in the loan portfolio. This has consequently impacted the reported profitability. In addition, QNB Group has renewed its operational rationalization exercise, which has resulted in cost savings, which reduced the cost-to-income ratio from 25.6% last year to 24.5%. Operating income increased to QAR 12.8 Billion or USD 3.5 Billion, up by 2% compared to the same period in 2019, demonstrating QNB Group's success in maintaining growth across the range of revenue sources.

Total assets reached QAR 972.1 Billion or USD 267 Billion, up by 10% from June 2019. This was driven by growth of 11% in loans and advances to reach QAR 704.8 Billion or USD 193.6 Billion. QNB Group remained successful in attracting funding, which resulted in an increased customer funding by 10% from June 2019 to reach QAR 712.2 Billion or USD 195.6 Billion. This maintained the group's loan-to-deposit ratio at 99%. The group was able to maintain the ratio of non-performing loans to gross loans at 2%, a level considered to be among one of the lowest amongst financial institutions in the Middle East and Africa region, reflecting the high quality of the group's loan book and the effective management of our credit risk.

That concludes our update. Thank you very much for listening. The floor is now open for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll now move to our first question over to phone. We'll take it from Waleed Mohsin from Goldman Sachs.

Waleed Malik Mohsin ***Goldman Sachs Group, Inc., Research Division - Equity Analyst***

Two questions from my side. First, on asset quality, if you could please talk about how much of your overall loan book is impacted or impaired within the current backdrop, both within your domestic and your international business. And if you could please link this to the QAR 1.5 Billion in provisions that you've taken. And how do you see the provision number moving during the rest of 2020? That's the first question.

And then, secondly, on your international business, I would be curious to hear what trends you're seeing in Egypt, Turkey and Ecobank. But more so in Turkey, we're seeing public sector banks in Turkey growing their loan books at around 30% on a sequential basis. So just wanted to get a sense of how QNB is responding to such market dynamics.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

With regards to asset quality, if we look at the momentum between Stage 2 and Stage 3, the percentage of loans in Stage 2 out of total loans moved from 4.7% to 5.5% in second quarter. I think this percentage will grow until December, and I think it could be 7% because this is the only way for you at this stage to build a reserve. If you want to build more reserves, you cannot keep loans in Stage 2 - Stage 1 because IFRS will not allow you to do that.

So the only way for you is to move some loans from Stage 1 to Stage 2 and Stage 2 to Stage 3. Now in terms of Stage 3, the percentage stood at around 2% from 1.9% last quarter. So the growth, most of the growth happened in Stage 2. Now if we look at cost of risk, total provision that we took, the incremental was QAR 1.5 Billion. Cost of risk moved to 70 basis points. In December, I think the percentage will continue to be between 70, maximum 75 basis points. If we do that, this will allow us to increase the coverage ratio.

Now in second quarter of the year, we were able to increase coverage ratio in Stage 3 from 99.5% to 100.1%. We were also able to increase coverage on Stage 2 from 7.3% to 7.4%. So this is the momentum I would like to keep until the end of the year, building on the coverage ratio. And the only way for me to be able to do this is to build a reserve. And for me to be able to do that again, I need to move accounts to Stage 2, some accounts to Stage 2 that for many other banks, there were no way this account would be classified as Stage 2. They definitely will be Stage 1.

This is a very conservative approach for me, for QNB to build a provision, Waleed. This is a strategy that we have been adopting for a long period of time. Now I need to identify an extremely important point. The way you analysts need look at financial accounts of QNB at this stage is that what happened in operating revenue, what happened in operating income, what happened in cost-to- income ratio and at the end, what we are doing in overall profitability.

In June of this year, growth in operating income is 2%. The growth in operating profit is close to 4%. Cost was managed in a way that allow us to reduce cost-to-income ratio from 25.6% to 24.5%. If you recall at the beginning of the year, when I was talking at cost-to-income ratio, I was quoting that it was going to be between 25% and 25.5%. We were able to end at 24.5%, which is an extremely important thing to do at this time. For a bank to be able to improve direction of the ratio, this is a very good sign of improvement in efficiency for the overall group. I, as a CFO, had to take advantage of current conditions to push in different levels.

The first push is to go back and remind executive management of how cost-conscious we have to be in order to manage the future. There were a lot of actions taken at the group level to manage costs. Even at December level, I expect that cost-to-income ratio for the group will drop materially from 25.9% last year to around 24.4%. This is the first parameter that I had to push for.

The second one is to push for in building a new buffer to protect the entity on the long term. And the only way for us to do that was through building on new provisions. Last year, total provision that was taken for the half year was QAR 1.3 Billion. This year, it's close to QAR 2.5 Billion. So, increment is QAR 1.2 Billion that mostly was taken as a buffer to protect the entity in the longer term. I am pushing more and more to build on this. This is an excellent year for any intelligent CFO to build on the capabilities of the entities where they operate, whether it was in terms of building on the cost-to-income ratio or building on the reserve to protect the entity on the longer term. This is the answer for your first question.

The second question, which is international business. Now overall business, whether for Egypt, Turkey or in the 30 countries where we operate, is not perfect. I was materially worried about Turkey. But in the last 40 days, I would say that things are materially better than I expected. And I don't see provisioning in Turkey in the third quarter. Fourth quarter will be as strong as it used to be in the second quarter, which is an extremely good sign. Turkey and Egypt in second quarter were materially helped by different aspects. The most important one of them is actions taken by the government by central banks to reduce interest rate by more than 300 basis points. Cost of funding cannot catch up with that drop within a month, and that's why net interest income in these 2 countries were impacted in the second quarter.

The second important impact is fees. Turkey and Egypt government took a decision to halt interest for 6 months period on credit cards and, to a large extent, on some commercial business. And that's why the fee income materially dropped in second quarter. This will continue in the third quarter. Fourth quarter, we should go back to normal. This is in terms of the impact of COVID on their businesses.

In terms of NPL ratio, in Egypt I am not seeing major pickup in their NPL. But what I can say is that we were very successful in improving their coverage ratio. Coverage ratio in ALAHLI moved from 149% in March to 156.7% in June. So again, taking advantage of the situation, build more on provisioning, see what the peer group is doing and be as conservative as possible. This is the momentum that you are going to see in this case in 2020. Waleed, did I answer your question, the second question? Or still, you need more data?

Waleed Malik Mohsin ***Goldman Sachs Group, Inc., Research Division - Equity Analyst***

That's very clear, Ramzi. Just one follow-up there. You said that over the last 4 or 5 days, you're less worried about Turkey. Anything in particular which makes you a little bit more comfortable? Because when we look at the data for the growth from the public sector banks, it seems that there continues to be a very big push on lending growth, which worries us about asset quality, but more so margins in the Turkish business overall in their industry. So just your thoughts on that, Ramzi.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Two strategies, and that was the growth in the first quarter that you have seen from QNB. And the second quarter, in particular, was not high because we saw the momentum of public sector. And we said, let's leave it and see exactly what will happen. Now they cannot continue that push forever. And in the last month of second quarter, we saw them slowing down. And in the third quarter, I think the growth in finance and the private sector would be higher than what you have seen in the first half, especially that margins are picking up again late in June, and we hope this will continue.

When I talked about that I'm a little bit more relaxed, mostly on the NPL. We, month by month, monitor the inflow of new loans. In April and May, we were extremely worried, and we started to build a big provision on a monthly basis. In June, we did not see major need for that extreme conservatism because we are not seeing a very strong momentum of new NPL coming. We hope that in the third quarter, this will continue. And that's why I think numbers for Turkey in the third quarter will be much better, but let's hope for the best.

Waleed Malik Mohsin *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it, Ramzi. And just last question from my side. Expenses, you mentioned, obviously strong cost control there. Is most of the cost rationalization done? And should we expect the operating expenses to be in line with second quarter? Or do you have more room? Because there was a substantial quarterly cost reduction, roughly 16%. So is there more room on the cost side?

Ramzi Talat A. Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

No, there's still a lot of room, Waleed. Because usually in expenses, the decision that you take today, the added value appears after 3 to 6 months period. Year-on-year, I'm projecting that overall cost for the group will drop between 7.5% and 9%. So there's still room for a decrease in cost.

Operator

(Operator Instructions) We now move on to our next question from [Melaine Chose] from Pictet.

Unidentified Analyst -

I have a question regarding the loan-to-deposit ratio. I would like to understand the sources of the lending growth and the sources of the deposit growth, meaning domestic versus international.

Ramzi Talat A. Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

Loan/deposit ratio improved in second quarter from 100.2% in March to 99% in June, which means that we are much more liquid in the second half, and this is a very good sign. The second good sign is that we have seen that the bulk of the growth in funding is coming from local markets, which allowed us to be more selective in where we are growing our non-resident funding. Now overall growth, I'm talking now in Doha because this is the important market that needs to focus on.

Growth in deposit was 9%, which is QAR 38 Billion. Out of the QAR 38 Billion, QAR 34 billion came from resident funding and only 4% came from non-resident funding.

Moving to the loan. Growth in loans was lower. It was only 6%. 4% was public sector. And when we look at public sector, we see that there were major drop in government loans. When the government generated the $10 Billion of bonds, they utilized a portion of that to reduce their exposure to bank, mainly QNB. So public sector loans only grew by 4%, whereas government loans overall dropped. Private sector loans grew by 7%. So to summarize, growth in loans, 6% only; 4% public sector, 7% private sector.

In terms of funding, overall funding is 9% growth; 15% public sector, 6% private sector, and the bulk of the growth came from government funding.

Unidentified Analyst

Maybe another question. This is more on the NIM, which is at 2.21%. What's the driver for the decrease in NIM? I mean regarding low interest rate or higher funding costs or both.

Ramzi Talat A. Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

At the beginning of the year, I was projecting a drop of around 6 to 7 basis points on NIM, and that was in January, when everything was perfect. Now I always told the investors that 100 basis points drop in Fed rate impact QNB by between QAR 400 Million to QAR 450 Million on an annual basis. Now what we have seen in second quarter, we have seen a drop of 125 basis points in 1 quarter alone. And that's why the impact on QNB, if we take an annualization, it will be around the QAR 550 Million to QAR 600 Million. And this is the normal thing, assume that there is no COVID, only take it, we take into consideration only Fed rate movement.

Now as I mentioned before, especially in some international markets, mainly Turkey and Egypt, there were some concessions given to private sector in terms of delaying of installment, reducing interest rate for some sectors that were materially impacted by COVID-19. This again put pressure on NIM. But all this is temporary, whether it was the drop in Fed rates, of course, it might, some people might say that it will be 1 year or more even, or even 2 years before it go back, go on up. There will be an impact, but what we are doing today, we are reducing cost of funding. But cost of funding must follow, and it's different from one bank to another. In our case, it is usually between 3 to 6 months period. So third quarter will continue to be difficult in terms of net interest income, whereas in fourth quarter, fees will start to pick up again. And at same time, the concession on some installment loans will stop, unless the government renew that concession.

Again, for June, overall drop in NIM was only 5 basis points. I think by December, considering what I mentioned before, the overall drop should be between the 7, maximum 9 to 10 basis points. If everything continue as we stand today, in terms of government not renewing concession given to some sectors in the business. But again, as I mentioned, this year, there will be an impact on net interest income, but my models still show that overall net interest income will grow by around 2%.

The second hit will be mostly in fees and margin, as I mentioned, because what happened in Turkey and Egypt, and it will only be in the second quarter, third quarter. Fourth quarter, we should go back to normal. These are the 2 major impacts in terms of operating income. We are compensating largely that impact through decreasing our cost and becoming more efficient. Becoming more efficient is long term, impact on interest and fees in short term, and this is a good story.

Operator

We now move to our next question over the phone. This comes from Christou, Edmond from Bloomberg Intelligence.

Edmond Christou ***Bloomberg Intelligence - Analyst***

I think you explained my inquiry here on the cost of risk. I just see that you have revised your macro indicator and the ECM model and the weighting, which is very positive. So the 75 to 80 basis points for the year, it's look like reasonable for the cost of risk. It's one thing.

The other thing is have you done the segregation between the exposure, short-term liquidity pressure from COVID-19 and significant credit risk on some account? Or do you expect more migration to happen in the year on the loan book?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Sorry, what migration you have talking about, please?

Edmond Christou ***Bloomberg Intelligence - Analyst***

Stage 2. So we have seen a lot of migration on Stage 2.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Yes, agreed.

Edmond Christou ***Bloomberg Intelligence - Analyst***

Yes. The second one is just on the pipeline, credit growth pipeline. It's less likely to see growth for the private sectors with the pressure coming from COVID-19 and low oil prices. But how do you see the opportunity within the public sector lending?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Migration. As I mentioned before, there are 2 types of migrations. There are normal migration because of weakness in the account, and the second type of migration where you need to migrate an account in order to build more provision if you want to be conservative. IFRS does not allow you just to build a general reserve. It's not acceptable. There is a model, you run the model and the number you get is the number you need to book based on the parameter you enter into the model.

If you keep the account in Stage 1, the percentage of provisions that you will take will be extremely low, which will not allow you to take the provisions that we want to be if you want to be conservative. This push us, in many cases, to move accounts, which is really Stage 1 to Stage 2. At the beginning of the year, Stage 2 loans was close to 5%. Today, Stage 2 loan is 5.5% of overall loans. If we want to continue this momentum, Stage 2 loan, I think, by end of this year, will be around 7%. That means that there is a collapse in QNB books.

It is a measure that QNB do in order for us to be able to add to the provisioning. What we need to see, what international markets are doing. Most banks is going to show a big drop in profitability this year, and there are two, and for different reasons. Some of them because their operating income is hit, and others because they want to build more provisions. In our case, we need to differentiate between how much additional provision that we have taken, okay, and the quality of QNB books. Please note that the bulk of QNB books in Qatar is government and government agency, which has zero NPL. So the room that I have or Chris has to build more and more provisions is limited, which force us, in many occasions, to move very good accounts into Stage 2. We feel that retail business in QNB is extremely low. So migration between Stage 1 and Stage 2 will continue. We will use this to build more provision, and that's why we are going to end up with cost of risk between 70 to 75 basis points.

The second part of the question was on loans now, overall guideline for this year. Loans and deposits will see a growth between 6% and 8%. And I think the growth in loans will be split between private sector and public sector. And if grew by around 6%, it was one of the lowest growth in loans that we have seen in QNB's history. Assets overall will grow between 5% and 7%. We are not pushing growth this year. We are going to be very slow. We are going to watch the market, especially in international market, and we are going to be very selective in where we grow in terms, mainly in loans.

Guidelines for the profit and loss is too early to mention. But if you tell me today, a ballpark number, I will tell you it will be between 12.5% to 17.5%. I need to wait for September to see to what extent peer group within the region and international market will be conservative. And based on this, the decision will be taken on to how much we want to be conservative and how much buffer we need to build.

Operator

We'll now move on to our next phone question, which comes from Rahul Bajaj from Citigroup.

Rahul Bajaj ***Citigroup Inc., Research Division - VP***

Two quick questions from me, if I may. You touched upon fee income trends in the international business. I just wanted to understand, I see a drop in fee income in the retail business, domestic retail business. I just wanted to understand what is driving that. So that's my first question.

My second question is mainly around the cost line. You touched around it, and you mentioned that there is hope to kind of further reduce cost. I just wanted to understand and clarify. So the decrease in cost that we have seen on a Q-on-Q sequential basis in second quarter, should we assume that to be the upper bound now going forward in terms of costs? So for a QAR 1.5 Billion number, excluding provisions, should that be seen as the upper bound now?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Now fee, to a large extent, is connected with volume of business. In the first half of the year, volume of business is weak, whether it was in terms of generating a new loan, credit financing business and credit card business because there is no spending. Spending is very limited, and that's why the more spending, the more credit card fees. So the first impact was spending is low, credit finance is low, and that is impacting your fees. Add to that, decisions by some international banks where we operate, especially Turkey and Egypt, to stop fee on some commercial business and more importantly, on the credit card business as a whole. So for Egypt and for Turkey, fees on these sectors is close to zero in second quarter, third quarter because the government chosen told them to stop it for a 6-months period, starting from March, ending in September. So the impact on fees will be lower level of business and government actions on some part of the fee business.

Now the cost line, as I mentioned, is a continuous process. And I think there will be new, more actions in third quarter and fourth quarter. And as I mentioned before that overall drop in costs that we see this year will be close to 9% and overall, between, let's say, between 8% and 9% from last year.

Operator

We'll now move on to our next question, which comes from Hootan Yazhari from Bank of America.

Hootan Yazhari ***BofA Merrill Lynch, Research Division - MD and Head of MENA & Global Frontiers Equity Research***

I have a couple of questions. So you were discussing on the cost base how you've made some strides in becoming more efficient and rationalizing that. Can you maybe talk us through where those cost savings are coming from and what areas you're particularly targeting? For example, is it fewer loan officers? Or are you reducing your spend in the digitization of the bank or whatever it might be? I just want to understand what the effect of such a significant cost rationalization will be. And should we return to some degree of normalcy in 2021, would you expect those costs to come back? Or are you just simply being able to operate with the same capabilities, just on a much lower cost base?

The second question is regarding dividends. And halfway through the year, the balance sheet is looking well capitalized. You're looking well provisioned. Your cost of risk looks to be under control. How are you approaching your dividends for this year? And how are you thinking about that?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Okay. Now in terms of cost. If you exclude Turkey and Egypt and you focus on QNB alone, our cost-to-income ratio is 16.7%, plus/minus. If you ask me at 16.7%, is there fat in QNB? I will tell you, of course, there is a lot of fat that need to be decreased. So if a bank that run with a cost-to-income ratio of 16%, 17% has fat, can you imagine other banks that have 40% or 50% cost-to-income ratio? Of course, many people will say it, the CFOs will always say there is fat. There is always fat in every single line in the cost, and when you want to be efficient, you start to negotiate everything in your contracts.

Today, all vendors providing service to you are under pressure. And your room to negotiate and reduce your cost base is materially higher. All advisory work that you utilize, you can go back and renegotiate. Many -- for example, training budget, you can manage it much better. Instead of international training courses, you can do the same locally. Assignment budget. Today, using Zoom or Team, you can cut your assignment budget by 50% to 60%, and you can take this as an example in every other line in the cost base.

Dividend. Dividend is connected, as per strategy, with profitability. And we always said that payout ratio for the group is between 30% to 40% as agreed with the Board, and this is directly connected with profitability. So naturally, if profitability will come down, naturally, dividends might come down. However, the decision is a Board decision. I cannot today say what will happen when the Board meets early January to decide on the dividend. But what I tell you that from a strategic point of view for QNB, the way the Board look at this is by looking at our capital adequacy ratio. Last year, our capital adequacy ratio was 18.9%. We, as an executive management, make sure to make very clear to the Board that for rating agencies, that ratio is extremely important, and we need to ensure that ratio exists.

Now I think, in June, the ratio was 18.3% because as per QCB instructions, we cannot include this year profitability in the calculation until December. So by December, when we include the profitability, that ratio should come back, and it will come back between 18.9% and 19%. And the payout ratio is connected with that ratio. All this stuff will be taken into consideration in the December decision. But naturally, if profitability is coming down and we must keep our capital adequacy ratio around the 19%, so this should impact the Board decisions. But at the end, no one can control what will happen in December and in January, when the Board decides.

Operator

We'll now move on to our next question over the phone, which comes from Vikram from NBK Capital.

Vikram Viswanathan ***Watani Investment Company K.S.C. c - Director***

This is Vikram from NBK Capital. I just had one follow-up on the IFRS treatment. You made a point that under IFRS, you cannot really build a general provision, unlike in the old accounting standard, because of which you will have migrate loans from Stage 1 to Stage 2 if you have to create more provisions. My question here is do you have enough flexibility under IFRS to move loans from Stage 1 to Stage 2. Because normally, for loans to be moved to Stage 2, they have to be on the watch list or they have to show some level of credit-quality degeneration. So is there a bit of a subjective element when you move loans from Stage 1 to Stage 2? That's my question.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

As I recall, there's around 14 or 15 criteria that you need to use to migrate accounts between Stage 1, Stage 2 and Stage 3, which definitely, once you have seen the criteria, there is some subjectivity in how you can move. At the same time, in the model itself, how much you are going to be conservative in the parameter that you enter allow you -- give you some room also in terms of, number one, migrating; and number two, the overall outcome of the provision. So definitely, the standard is not 1 plus 1 equals 2. There is all the subjectivity that give room to the bank that wants to be conservative to take advantage and move some accounts based on that subjectivity.

Vikram Viswanathan ***Watani Investment Company K.S.C. c - Director***

All right. That's very clear. Just on your earnings guidance, did you say...

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

(inaudible) The next point that I wanted to mention on this, if you recall, Vikram, if you go back to QNB account before IFRS 9, our coverage ratio was 114%, 115% because at that time was able to have more than 100% on Stage 3. Today, that's extremely difficult to close to impossible. So the only way for me to build a buffer, it cannot be on Stage 3, it has to be Stage 2. Okay?

Vikram Viswanathan ***Watani Investment Company K.S.C. c - Director***

Sure. Just a follow-up on the earnings. Did you say this year; you expect earnings to decline by about 12%, 13%? Maybe I missed the number or maybe you did not give an earnings guidance.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

I said between 12.5% and 13.5%.

Operator

(Operator Instructions) We now take our next question from Naresh Bilandani from JPMorgan.

Naresh N. Bilandani ***JPMorgan Chase & Co, Research Division - Research Analyst***

It's Naresh from JPMorgan. Ramzi, I think it was very clear on the presentation. Just two quick questions on some idea that you've already provided. If I take a look at the Qatari segment, I think if I do a rough NIM calculation, that continues to have stayed quite stable even in the first half of the year without despite the rate cuts that we have seen.

My understanding is that because of the loan forbearance and support, deferral support that was provided, there could have been some pressure on the NIM, but the stability is a bit of a surprise. So I'm just trying to understand if we may still see some decline in the domestic segment NIM through the rest of the year. And I'd highly appreciate if you could please reconfirm the guidance that you provided for the net interest margin early in this call. Because I think you mentioned that from here on, you probably see 7 bps impact. Was that from the first half level? Or were you talking about for the whole year? That would be my first question.

My second question is on growth. Now Mark, during his part of the presentation, he mentioned Qatar's renewed hydrocarbon push. If we leave 2020 aside for a moment and take like a 3- to 5-year view, and we've seen very heady growth rates in Qatar in the early part of this decade, if considering the state's hydrocarbon pushed again, if I had to take a medium-term view, how much do you think, to what extent, can this drive the loan growth at your domestic segment? That would be very helpful.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Now local NIM. Some accounts in local NIM will be renewed in, they are connected with 6 months LIBOR. So the impact on them will be on the third quarter, not second quarter now. Now when I mentioned the 9 to 10 basis point drop, I was talking about from December to December, from January, so from January to December, so full year movement.

Now in terms of 3 to 5 year movements in loans. I will tell you what, I just want to get rid of 2020, and then I will start thinking about later. Now the momentum, Naresh, is that there is a lot of projects that state is taking good price in terms of building loan, whether it was the North Field, then after that, projects and other long-term projects that they are, they have announced. The bulk of the investment for these projects will take place in the next 3 to 5 years. Now how much the state will finance out these projects, we need to wait and see. Persistently, it was around 50% of the overall exposure. So we're talking about huge number of investment that will take place. So definitely, growth in loans, especially in Doha in 2020 and beyond will be materially higher than what we are seeing in 2020. But to give you today a very clear picture, this will be too early.

Operator

We'll now move to our next question, which comes from Janany Vamadeva from Arqaam Cap.

Janany Vamadeva ***Arqaam Capital Research Offshore S.A.L. - Analyst***

This is Janany from Arqaam Capital. I just have a quick question, if I may. If you're able to share with us, just wondering what percentage of your loan book is on payment holiday or deferral now. And what percentage do you think is caused by like temporary liquidity issues? And how much would you sort of expect to attribute it to underlying going concern issues? If you can share with us, that would be great.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Now in Doha and local operations, excluding Egypt and Turkey, it's still small, I think it's around...

Durraiz Khan ***Qatar National Bank (Q.P.S.C.) – Head of Group Financial Consolidation and IR***

2.5%.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Two-point, it's only 2.5%. Egypt and Turkey together, I don't have the number. But again, if you take overall group number, it's not that huge. And definitely, it will not impact going concern.

As I mentioned before, the portion of government and government agency business for QNB overall, it differentiates QNB from many other banks, whether it was in the region or internationally.

Janany Vamadeva ***Arqaam Capital Research Offshore S.A.L. - Analyst***

Do you think you can share like which sectors this 2.5% or broadly retail or corporate, if you're able to?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

No, it's not retail. Zero retail. The bulk will be SME and mostly medium-sized corporate.

Janany Vamadeva Arqaam Capital Research Offshore S.A.L. - Analyst

And just to see that I got the guidance correctly. The full year net profit declined with 12.5% to 17.5%. Is that the range you mentioned?

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Yes. But I want to add more data on this. These numbers in terms of guidelines, especially on profitability, will be materially impacted by what's happening in the region in terms of what banks is going to do. We are not going to go out and say we are down by 17.5% if the peer group internationally or/and regionally is growing by 4%, 5% because that would be like we are shooting ourselves in the foot, okay?

We want to be extremely conservative, and we want to build a buffer, taking advantage of things on the ground in the international markets and what is being faced by banks internationally because we know that our book in terms of quality is much better than the rest of the market. So it doesn't make sense to QNB to grow by 5% when the market is down by 25%. We saw what happened in March, and we said that many banks are showing 40% and 50% decrease. We should not be breakeven. Let's be conservative, let's take advantage of this and build a buffer.

Now if in June and September, we see banks regionally and internationally are going back to normal and growing by 4%, 5%, this number will definitely change and you will see us positive again. So, and this is why I'm saying this is highly dependent on what's happening around that and what banks are issuing. We are not going to be the only bank that issue negative number to be conservative and building a buffer because that's not the right way to do it. We are taking advantage of the situation. If everyone is under pressure, and they are showing negative numbers because they are under pressure, we will build a buffer even though we know the quality of our book. If not, we will not do that.

Operator

As we have no further questions queued over the phone at this time, I would like to turn the conference back over to Ms. Sanchez for any additional or closing remarks.

Elena Sanchez-Cabezudo ***EFG Hermes Holding S.A.E., Research Division - MD & Head of Financials Equity Research***

Thank you, Simon. We can now conclude the call. I would like to thank QNB's management for their time today and for all the attendees for taking part in the call today. Have a good day. Thank you.

Ramzi Talat A. Mari ***Qatar National Bank (Q.P.S.C.) - Group CFO***

Thank you, everyone.

Operator

Ladies and gentlemen, this does conclude today's call. Thank you very much for your participation. You may now disconnect.
