Transcript Analyst call 2Q2023

Presentation

Operator
Good morning, this is Marion, welcoming you to ING's 2Q 2023 conference call. Today's conference is being recorded.

Before handing this conference call over to Steven van Rijswijk, Chief Executive Officer of ING Group, let me first say that today's comments may include forward-looking statements, such as statements regarding future developments in our business, expectations for our future financial performance and any statement not involving a historical fact.

Actual results may differ materially from those projected in any forward-looking statement. A discussion of factors that may cause actual results to differ from those in any forward-looking statement is contained in our public filings, including our most recent Annual Report on Form 20-F filed with the United States Securities and Exchange Commission, and our earnings Press Release as posted on our website today.

Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any securities. Good morning, Steven. Over to you.

Steven van Rijswijk
Good morning and welcome to our second quarter 2023 Results Call. I hope you're all well. As usual, I'm joined by our CRO Ljiljana Čortan and our CFO Tanate Phutrakul, and I'm pleased to take you through today's presentation. After that we will take your questions.

The second quarter was another strong quarter for ING and we delivered good results, especially in an environment characterised by ongoing macroeconomic and geopolitical challenges. Our continuous focus on offering a superior customer experience results in good organic growth. We added 227,000 primary customers, with many customers in Germany, the Netherlands, and Spain selecting ING as their primary bank.

The share of mobile-only customers increased further, and 60% of our retail customers only do business with us through their mobile, our main channel. In Wholesale Banking, the volume mobilised to help our clients transition to more sustainable business models reached €47 billion in the first half of 2023, a growth of 17% compared with the first six months of 2022.

We continue to benefit from the positive rate environment and our total income grew by 23% year on year, mainly driven by high interest income on liabilities. Our four-quarter rolling average return on equity increased to 11.7%, and we have achieved this while operating on a very healthy CET1 ratio of 14.9%. On August 14th, we will pay an interim cash dividend over the first half of 2023, amounting to €35 cents per share, which brings our total year to date distribution to shareholders to around €4.5 billion.

Before moving to the financial results in more detail, I will spend some time on the progress we're making in the execution of our strategy and related targets.

On slide 3, our purpose and strategic priorities are shown. The first priority is to deliver a superior experience, which remains one of the most important reasons for customers to choose and promote ING as their primary bank. As a result, it's one of the key drivers for customer growth. To enable this growth, we continue to invest in our scalable tech and operations foundation and focus on offering a seamless digital experience. In the first half of this year, we have increased the straight-through-processing of retail customer journeys to 69%. This means that 69% of our key customer journeys is handled without manual intervention, which is getting closer to our 2025 target of >75%.

Another highlight this quarter is that in the Netherlands 63% of our new clients were digitally onboarded, up from 52% at the end of last year.

Our second strategic pillar is sustainability, where an important aim is to support our clients in their transition to more sustainable business models. As our people are essential to putting sustainability into action, we organised our first global sustainability week in June. Colleagues from around the world participated in more than 80 online and in-person sessions to share knowledge, inspire each other, and exchange views on how to make a difference both in and outside their work.

We also expanded our product offering to help clients make energy efficient renovations. In Belgium, we launched a new eco renovation loan to support business banking clients in making their real estate more sustainable.

Now we are moving to slide 4, which shows our strength in a positive rate environment. The graph shows our total income since 2018, and it's clear that our continuous focus on income diversification and our ability to capture loan growth through-the-cycle has paid off, as we were able to offset the pressure from the low rates and keep our income stable.

Now that the interest rates have turned positive, the strengths of our business model are highlighted. We have an attractive funding structure, with over 60% of our balance sheet funded by sticky customer deposits. We have a proven ability to grow the number of clients and attract additional deposits. This was again clearly evidenced this quarter through our successful promotional campaigns, which result in significant inflow of deposits in Germany, our largest market in terms of number of clients. And thirdly, through our diversification, we can capture long growth through the cycle. This was evidenced again this quarter with €2.7 billion growths in mortgages, despite the fact that the number of transactions in the market was down significantly. These positive impacts are already visible in the P&L with income being structurally higher than in previous years.

Going forward, we expect continuous tailwind from these higher rates. Given the structure of our replicating portfolio, around 55% of the €480 billion replicating portfolio is reinvested longer than one year and will continue to reprice at higher rates in the coming years. Lastly, a return of loan demand and asset margins are a catalyst for future income growth, and we expect to be able to further grow fee income.

Slide 5 shows our financial targets for 2025 and our performance in the first half of this year. On fee growth. In daily banking, we see further room to increase or introduce fees. In investment products, the continued growth of accounts is a strong base for fee growth when market confidence improves. Further support will come from growth of lending fees when overall demand recovers. Higher fees and continued focus on income diversification will support total income growth, though for 2023 the main driver will continue to be liability NII. While there are some uncertainties such as further central bank rate increases, deposit tracking and customer behavior, the tailwind from our replicating portfolio on liabilities will continue.

This income growth will support an improvement in our cost-income ratio, which has already declined to just over 54% on a four-quarter rolling basis. Our costs are well controlled despite the pressure from high inflation, and we also continue to invest in our strategy enablers and in marketing, which will support commercial growth and bring cost benefits in the longer term. On our CET1 ratio, we intend to move to our target of around 12.5% in roughly equal steps, through our 50% payout of resilient net profit combined with additional distributions. The next step will reflect the strong capital generation and we will update the market with the disclosure of our third quarter 2023 results.

Good to highlight here is that the Dutch Central Bank reduced the systematic risk buffer requirement for ING from 2.5% to 2.0%, while at the same time increasing the Dutch countercyclical buffer from 1.0% to 2.0%. As a result of these adjustments, our fully-loaded SREP requirement decreased by roughly 32 basis points with 10.7%. As a result, we will not adjust our CET1 targets.

Despite risk costs below our through-the-cycle average and no identifiable trends in provisioning, we remain vigilant, as the cost of living and doing business rises for our customers. Driven by all these factors, we have confidence we'll reach our targeted 12% return on equity.

Then on to the second quarter results starting on slide 7, which shows the continued strong development of NII. Liability NII was even higher than the shown headline number as accounting impacts shifted some NII from Treasury and Financial Markets to other income. The increase in liability NII reflected further rate increases and continued deposit inflow, which was only partly offset by an increase of the core rates in some of our retail markets. The positive impact was also clearly visible in Wholesale Banking, with our payments and cash management business benefiting from higher interest rates.

In lending NII we saw year-on-year pressure on mortgage margins due to the rising interest rates, as client rates generally track higher funding costs with a delay, while also income from prepayment penalties was negligible. Sequentially, this effect diminished and lending margins have stabilised.

As mentioned, year-on-year we saw the impact of a temporary shifts of NII to other income as Treasury benefited from favorable market opportunities through money markets and FX transactions. For Financial Markets, rising rates and increased business led to higher funding costs. Accounting wise, this resulted in a reduction in net interest income while other income rose significantly.

Our net interest margin for the quarter decreased by 3 basis points to 156 basis points, fully driven by the increase of the balance sheet total, which more than offsets higher NII.

Slide 8 shows net core lending growth. In Retail, mortgages continue to grow, mainly in Australia, the Netherlands, and Germany, despite the fact that mortgage transactions in Germany and the Netherlands dropped significantly.

In Wholesale Banking, loan growth was visible in Lending. This was more than offset by lower utilisation in Working Capital Solutions and lower volumes in Trade & Commodity Finance, reflecting a decrease in commodity prices and lower economic activity.

Going forward, with still heightened macroeconomic uncertainty, we expect low demand to remain subdued.

We benefited from our diversified business model as we grew net customer deposits with €17 billion, primarily reflecting the success of our promotional campaigns in Germany where we had €16 billion of deposit inflows. Roughly 2/3 of this inflow came from existing customers. Wholesale Banking recorded a small outflow.

Then we turn to fees on page 9, which showed growth year-on-year driven by increased deal flow in Wholesale Banking Lending and Global Capital Markets. In Retail Banking, the growth of primary customers and the increase in payment package fees was offset by lower fees year-on-year for investment products, which continues to be affected by less trading activity. However, the opening of new investment accounts continued and assets under management increased, which will result in higher fees when market activity recovers as we will grow from a higher base. Sequentially, fees were up also reflecting an increase in fees in Wholesale Banking driven by Lending, Global Capital Markets and Corporate Finance. Fee income for Retail Banking was stable.

Now we move to slide 10. Excluding regulatory costs and incidental items, operating expenses were up 6.9% year-on-year. This was mostly due to the effect of high inflation rates on staff expenses, reflecting indexation and CLA increases across most of our markets. We also continue to invest in growing our business, including higher marketing expenses. These factors were partly offset by positive FX impacts and the exit from the retail markets in France and the Philippines.

Quarter-on-quarter, expenses excluding regulatory costs and incidental items decreased with 0.5%, despite higher staff expenses. Last quarter had included €44 million of legal provisions and structuring costs while these amounted to €22 million in the second quarter. The regulatory costs were down year-on-year as the second quarter last year had included a €92 million contribution to the Institutional Protection Scheme in Poland. Our contribution to DGS funds has decreased as well. The quarter-on-quarter decrease on regulatory costs reflected the full payment of several annual contributions that we took in the first quarter of this year.

Then risk costs in the next slide, that's slide 11, which were €98 million this quarter or 6 basis points of average customer lending, below our through-the-cycle average of 25 basis points. This included a €39 million increase of management overlays, mainly reflecting the current inflation and interest environment, as well as some regular model updates. The total stock of management overlays amounts to €560 million at the end of the second quarter 2023.

In Wholesale Banking, risk costs included a few individual files, and this was however more than offset by a further release of our Russia-related provisions, as we continue reducing our Russia-related exposure. Total offshore exposure with regards to Russia amounted to €1.7 billion at the end of the second quarter. Total risk costs in Wholesale amounted to €-15 million.

In Retail Banking, there were limited additions to risk costs in Poland, Spain, and Belgium. In stage 3 we saw modest inflow with no clear trends identifiable.

The stage 3 outstandings declined slightly this quarter, while the stage 3 ratio remained low at 1. 4%. The lower stage 2 ratio mainly reflected sales and repayments, including a further reduction of our offshore Russia-related exposure.

All in all, a very benign quarter in risk costs. Although cost of living and doing business rises for our customers, we remain confident in the quality of our loan book.

Slide 12 shows our CET1 ratio, which increased to a very strong 14.9%. CET1 capital was nearly €500 million lower as the distribution of €1.5 billion was largely offset by the addition of 50% of the resilient net profit for the quarter. Furthermore, risk weighted assets were €4.5 billion lower, including €200 million of FX impacts. Credit risk weighted assets decreased by €5.6

billion, mostly driven by model updates an improved profile of the loan book, as well as disciplined capital management in Wholesale Banking. On distribution plans, we will pay an interim cash dividend of 35 cents per ordinary share over the first half of 2023 on August 14th. We will update the market on our future distribution plans with our third quarter of 2023 results, and as mentioned before, the next steps to converge to our CET1 ratio target of 12.5% by 2025 will reflect the strong capital generation.

To wrap up with the highlights, a strong second quarter in which we delivered an excellent set of results. Execution of our strategic priorities delivered strong growth of primary customers and we increased our volumes mobilised to finance a transition to more sustainable business models. The financial results in the first half of the year clearly demonstrate that our business model and strengths position us well to benefit from the positive rate environment. Total income increased, with growth across all segments, and expenses remained under control. Our capital position remains very strong and we are well positioned to continue providing a very attractive return to our shareholders. Going forward, I'm confident that we will continue to deliver robust financial results while successfully executing our strategy. And with that we move to Q&A.

Q&A

Operator
Thank you. If you would like to ask a question, please press star one on your telephone keypad. To withdraw your question from the queue, please press star two to cancel. Again, please press star one to ask a question over the phone. We'll take the first question from Jon Peace from Credit Suisse.

Jon Peace (Credit Suisse)
Yes, thank you. Good morning. My first question, just on net interest income, I realise that Treasury swap reallocation to other income can be volatile on a quarterly basis, but should we be just adding on that reallocation to the current quarters NII and seeing €4.4 billion of NII as really a sustainable base for the second half of the year, and for 2024 given your comments about the tailwind from the replicating portfolio. Second question please, just on the cost of risk. Any guidance you might give us for the second half of this year relative to your through-the-cycle rates? You're obviously still carrying quite a degree of overlays and I just wonder if there's any pressure to utilise those which might keep the cost of risk very low. Thank you.

Steven van Rijswijk
Thank you very much. Jon, I'll give the first question to Tanate, and then the second one to Ljiljana.

Tanate Phutrakul
Thanks, Jon. Just on NII in particular, the two elements are our transactions in Treasury and our position in Financial Markets. As we have given you in the last quarter, we guided that the trades in Treasury was likely to be about the same in Q1 and Q2, and that has been the case. Our expectation is that the opportunity will exist going into the second half of the year, but the impact will start to decline a bit in Q3. In Financial Markets, it really just depends on our trading position. That's all too volatile to predict.

Ljiljana Čortan
Good morning. Also from my side, with respect to the cost of risk guidance, as you know, we generally do not guide on that category and we refer to our low through-the-cycle 25 bps average compared to customer lending. However, as you see the first half of this year has been very good for the quality of our portfolio, proven the resilience and quality of our portfolio. But as our CEO mentioned, we remain vigilant with respect to the uncertainty in the environment, and that's why we are sticking to our through-the-cycle that much.

Jon Peace (Credit Suisse)
Okay. Thank you.

Operator
The next question comes from Giulia Aurora Miotto from Morgan Stanley. Please go ahead.

Giulia Aurora Miotto (Morgan Stanley)
Hi, good morning. My first question is on NII as well. You mentioned tailwind still to come. 55% of the replicating portfolio has duration longer than one year, given that we expect the ECB rates to peak and then start decreasing next year, when do you think your NII will peak, essentially? Timing of the peak of NII is my first question.

Then the second question on asset quality at the moment remains very benign, but is there any portfolio that you're watching more carefully in particular on the commercial real estate side for instance, or residential markets in the Netherlands or Australia? Thank you.

Steven van Rijswijk
Yes, hi Giulia. Thank you. I'll give the second question to Ljiljana, the first question I'll do. To some extent a similar question as the previous as Jon, but look, I think the good thing is that we are operating in a number of markets, so it's diverse and we continue to attract deposits. One of the elements that's important, are we continually able to get clients in, are we continually able to attract deposits? The second element is, what is the competition doing in these different markets, and the tracking speed so far has been around 20%. We will need to see how that will develop, but it's still significantly lower than we've seen in previous cycles. Then of course, it also depends on the increase in interest rates that we see with the ECB.

Now, it's hard to predict what exactly will be, but people expect either one or two more hikes. But that competitive impact will remain to be seen, and we will play our role to see how do we balance it out. In terms of the role that we play in different markets, we're typically more of a follower in, let's say, the incumbent markets in which we're active. And where we grow our number of clients, in the let's say challenger markets, we sometimes do marketing actions to attract customers like we have seen now in Germany for example, and that led to also an incredible amount of €16 billion additional deposits. The good thing is that interest rates at some point will rise, but we have a replicating portfolio with the majority, indeed 55%, of our replicated deposits which is replicated for longer than one year, and that will be a good support even when competitive pressure increases to further benefit from this interest rate environment. And what the level exactly will be, we will need to see depending on the market circumstances.

Ljiljana Čortan
Good morning Giulia, also from my side. Correct, our asset quality remains strong and resilient as well in the second quarter, and we do see some better prospects eventually in some of the geographies we operate in. However, this uncertainty is still there and thus as said, we remain vigilant when it comes to the higher interest rate and inflationary environment. Specifically across the portfolios that are experiencing higher, I would say cost of doing business or higher borrowing costs, but as well for private individuals cost of living. That means that obviously the focus is on the more cyclical parts of the portfolio. Clearly, we are looking at commercial real estate, at acquisition finance, but as well some other still energy intense manufacturing parts of our portfolio. So far we do not see structural deteriorations there, but that's also one of the reasons why we proactively take the measures in order not to allow those to become visible. Thank you.

Giulia Aurora Miotto (Morgan Stanley)
Thanks.

Operator
The next question comes from Raul Sinha, from JP Morgan.

Raul Sinha (JP Morgan)
Good morning, everybody. Thanks very much for taking my questions. Two from me as well. The first one Steven, I was just wondering if you think you have seen the peak in inflation pressure on the cost side and the reason, I ask that is because I think costs came slightly below where the market is expecting. They seem to be analysing just below where consensus is sitting. For the full year, would you expect perhaps there to be more or less cost pressure in the second half of the year compared to what you've delivered here? That's my first question.

Then the second question, just coming back on NII some of the other banks which do have Financial Markets, businesses where the funding cost of the Financial Markets business is still booked in NII are moving towards a banking NII definition in particular HSBC or Standard Chartered in the UK. I guess you guys have the same accounting asymmetry. So, I was wondering whether you considered perhaps at your end to refine the definition of NII or perhaps give us another measure in terms of banking NII. Thank you.

Steven van Rijswijk
Thank you. Maybe I'll do the second question first. Currently, not considering to redefine a definition, but I can see that it requires some explanation because it indeed moves from NII to other income. Tanate, I'll give you the first question.

Tanate Phutrakul
Hi Raul, just on cost development in the second quarter, probably three things to note. The first, our regulatory expenses are down €247 million, so right, a good evolution. We have guided the market already that by 2025, we expect that regulatory expenses will be €400 million lower than where we see it's today, where we see it in 2021. Our expectation is that the regulatory expenses for this year will be approximately €180 million lower than previous years. That's on regulatory expenses.

On Opex, yes, we do see that the inflation pressure is coming down. Indexation in Belgium, which used to be 10% in December, by June this year has gone down to around 4.0%-4.5% so that pressure is coming down. But having said that, we also do spend more money in terms of client acquisition and more advertising, and those are also present in our numbers, but a 7% Opex cleaned for volatility is a good guidance of where our Opex have run in Q2.

Raul Sinha (JP Morgan)
Thank you.

Operator
The next question comes from Tarik El Mejjad from Bank of America. Please go ahead.

Tarik El Mejjad (Bank of America)
Hi, good morning. Thank you for taking my questions. A couple from my side. The first one on the revenues, maybe just to summarise a bit what you've been saying for my colleagues' previous questions. I noticed in your slides, in Q2 slides that in the targets for total income, you removed the line with above 10% total income growth for 2023. Obviously, consensus is double that, and you are showing strong trends. Can you maybe update that guidance or tell us what you think about where consensus sits maybe that give us view on where the fees and NII trends from here.

Then second question is on the capital and distribution. I appreciate you're doing an update in Q3, but that's been an issue here for a while already where you clearly generate more capital than you can distribute, which is a good problem to have, but when you do the maths, it's very difficult to imagine how you can converse to 12.5%, and you reiterated that last Friday after the stress test today in every occasion. That implies massive step up in the distribution in the special every year starting from Q3. Is that something that could be on the table?

Second question, how can you deliver that given the liquidation of the shares and so on? Does that mean that you'll have also some cash special and not only buyback on top of the current runrates? Thank you.

Steven van Rijswijk
Okay, thank you, Tarik. Let me start on capital distribution. We do the math as well, and so indeed our capital moved up again on the back of these results and also on the good capital management, especially in Wholesale Banking this quarter.
What I also said in the presentation is that we will give an update in the third quarter, but that we also see that the roughly equal steps, if we want to move, and we want to move to around 12.5% that hasn't changed, it also means that the steps need to reflect the higher capital that we're having. I think that what you're saying and I am saying are exactly the same, with having that math in mind. Then on revenues no, we're not giving additional guidance above 10% and with conference I can say it's above 10%.

Operator
The next question comes from Benoît Pétrarque from Kepler Cheuvreux.

Benoît Pétrarque (Kepler Cheuvreux)
Yes, good morning. Thank you for the presentation. Now just to first come back on the accounting asymmetry, which create a lot of noise obviously, and maybe focusing on the Financial Markets NII.

Clearly, quite difficult to estimate, but I understand that the trend was very much linked to the ECB rate cycle. When this cycle will stop or we get probably a cut even at some point, it's fair to assume that the NII from Financial Markets will recover sharply potentially back to the previous level, but I wanted to check that with you first.

Then on the stress test outcome, sorry to come back to that, but it was 550 bps negative on your CET1. I think you were ending at just below 9% in the adverse scenario with a starting point at 14.5%. Can you really bring the CET1 ratio back to 12.5% given your sensitivity to an adverse scenario according to ECB? That will be the question and also linked to the capital distribution.
I was wondering if you think we can plug payout ratio blended, including buyback, above 100%, if technically, there's no issue because obviously if you want to bring your capital down, we have to think about payout ratio above 100%. I wanted to make sure we can do that without much problems. Thank you.

Steven van Rijswijk
Okay, let me answer the question on CET1 and then Tanate will talk about Financial Markets. With regards to CET1, and you mentioned the stress test, it was of course a very insightful stress test. It's also quite a static stress test and the input factors of that stress as this time had their impact on banks with presence more in the northern part of Europe. That's what you see reflected.

The stress test does not talk about how you would respond to this stress, which typically is being done. But this is just a stress test, which is good, and we do many stress tests. Then separate from that, we have very good capital of 14.9%. We have a target capital ratio of 12.5% that we've also at the time agreed with the ECB and we are confidently moving in roughly equals steps to the 12.5%. You're right, that in that mathematical calculation, that means that on aggregate we need to pay out more than 100% of our profits to get there. So, we are calculating as well, and will give you an update in the third quarter.
Tanate Phutrakul: Benoit just on NII, it really is more volatile and harder to predict, but it depends really on two factors. The first one I think will be sustained for some time to come, which is that the absolute cost of funding is higher. That clearly will be visible in coming quarters, but at the same time, it also depends on our trading strategy on the product mix demanded by our customers. I think it remains a volatile line item from NII FM perspective.

Benoît Pétrarque (Kepler Cheuvreux)
If you think about 2024 on the FM NIII, do you think we can go back to the €300 million run rate or will that be too positive?

Tanate Phutrakul
No, I think it's harder to predict, but as I said, the big driver is that the absolute level of borrowing cost is higher given central bank rates, and it depends on the product mix from our clients.

Benoît Pétrarque (Kepler Cheuvreux)
Okay, thank you very much.

Operator
The next question comes from Benjamin Goy from Deutsche Bank.

Benjamin Goy (Deutsche Bank)
Hi, good morning. Two questions. One, to follow up on the 12.5%, is there any material risk weight inflation from a regulatory point of view, in your view? And say by 2025, would you keep a buffer for cyclical action when your risk weights increase? Then secondly, a bit more high level of a bigger picture question. Anything on AI you would like to flag you're currently doing or opportunities to see going forward? Thank you very much.

Steven van Rijswijk
Sorry, the second question.

Benjamin Goy (Deutsche Bank)
Generative AI. Artificial Intelligence.

Steven van Rijswijk
Okay. So let me start with the second one. We currently do use AI in a number of our processes such as contact centres, or collections, or marketing propensity models, for example. That helps us and that can also help better decision making if you do it in a fair and transparent way. That's the most important thing, especially with AI.

When we talk about generative AI, yes, that is new. Currently, in ING, we have forbidden people to use generative AI in ING processes, and we will in a sandbox experiment with two initiatives, just completely separate from anything else to better understand what the benefit is, because it could have a benefit, but also how we can control it. Before we are able to control it, we will not roll this out in our organisation.

We first will separately test it as we always do with innovations, and then see to what extent we will roll this out in the organisation. With regards to the capital, or with regards to the RWA, there are two elements. I will answer one of them. If you ask, are you keeping a buffer in the RWA. I think what you may mean is to what extent are you taking counter cyclical buffers into account in your capital levels, in this case around 12.5%, and we have. The capital levels and the buffers are all in the 12.5%. So we've taken into account. Then you also said something about Basel IV or regulatory impact on RWA. For that I give the floor to Ljiljana.

Ljiljana Čortan
Thank you. Good morning, Ben. As we've informed you several times, we have through our models, all through the overlays, absorbed most of the expected regulatory RWA inflation ahead of 2025 Basel IV implementation, but as also said several times before, and also seen this quarter, there are some quarterly adjustments that come from the regular life cycle, which can be related to methodology or policy update or calibration of existing models.

These impacts might come in or revert back, but through the cycle, the majority of the impact has been taken into account in existing numbers.

Benjamin Goy (Deutsche Bank)
Very good. Thank you. So it really is more than 100% payout to get to the target. Thank you.

Operator
The next question comes from Kiri Vijayarajah from HSBC.

Kiri Vijayarajah (HSBC)
Yes. Good morning, everyone. A couple of questions from my side. Firstly, coming back to the deposit campaign in Germany, just a bit more colour there on what the thinking was because was it about accelerating the primary customer number because it did feel like you'd lost a little bit of momentum at 1Q when I compare you to the run rate of last year? Or was it more about managing your overall deposit numbers because I think you did have some outflows on the Wholesale side so you wanted to compensate there, and should we view that campaign as a one-off and or could we see more of those deposit campaigns being repeated in some of your other geographies?

Then secondly, turning to the loan growth side, all looks fairly robust and well balanced across the different divisions and geographies. Is the aim to put the deposits to work quite quickly into loan growth, in which case maybe you're hoping to see a bit of a pickup or are you happy to let that cash flow into the replicated portfolio? I guess I'm ultimately asking how sticky you think those new deposits are in terms of how you're going to redeploy that. Thank you.

Steven van Rijswijk
Good questions. Thank you. Now the deposit campaign in Germany was focused on gaining customers, and I don't know how many of you know, but we have a stated ambition of getting to 10 million customers in Germany by the end of 2025. We're currently at 9 million. Of the deposit inflows, over 2/3 came from existing customers, which is good.

Typically, customers that are already existing and they bring more money to the bank are more sticky, so that's helpful. We have a lot of experience with marketing campaigns over the past number of decades. Of course in a big part of our business, retail banking, in many countries and in countries where we want to grow our customers, we now again have promotional rates. So not core rate increases, but promotional rates to attract customers, and we do that as well as we can in timing the moment. And this case we were the first big bank who started a savings campaign, which was very well timed, because then it caught the attention of the public, and that's how we are looking at it.

Whenever there's opportunities, we will look at that further in all the markets in which we're active. And in general, typically in the incumbent market of the Netherlands and Belgium, we will be more of a follower. And we can be more assertive in these promotional campaign in other markets, but that really depends on the market circumstance. When it comes to loan growth, look, in the end, we are really focused on being prudent here. What you see is that the mortgage market has come down in the biggest three markets in which were active, which is about 80% of our total mortgage portfolio of a bit over €300 billion, which comes from the Netherlands, Belgium, and Germany. In these markets, the new dwellings that are being sold are down between 40% and 50%. In that sense, the market is benign or is not actually active. What was good is that we were able to increase the number of mortgages sold and increase our books, but on a relative scale that is limited and the focus is on making sure that people can repay and we do not loosen our credit standards because we now have more deposits and we remain very vigilant of what's going to happen in the next quarter.

Kiri Vijayarajah (HSBC)
Great, thank you.

Operator
The next question comes from Amit Goel from Barclays.

Amit Goel (Barclays)
Hi. Thank you for taking my questions. I've got a few just relating to the slide 16 replication portfolio. One, I just want to check on the size of the books. It seems to have grown from about €460 billion in Q3 to €480 billion, so it's outpaced the growth in the deposits. Just curious how you are driving the size of that portfolio and the incremental piece, how you are reinvesting that. Secondly, in terms of the 55% of the book, which is greater than one year can, you give us an idea of what the duration is on that part of the portfolio or how that's structured?

Then lastly, just on the pass through just curious, I guess relative to that average rate of 20% during the quarter, how that's tracking towards the end of the quarter and into the start of Q3. Thank you.

Steven van Rijswijk
Tanate, this seems like a lot of questions for you.

Tanate Phutrakul
Amit, thank you very much. The level of deposit growth, it's really something that is driven by customer growth, customer activities, and the prevailing market. The growth in liability is actually welcome from that perspective, and unlike when we were in negative rates, liability replication was actually P&L negative, but now replication is P&L positive, so that's a good sign. We have given you this guidance on replication of 45%-55%, and from that perspective that we replicate about that same level depending of course on different market as well. The pass-through rate, we are at about 20% as of the NII Q2, but we expect that year to date it's around 29%.

Amit Goel (Barclays)
Okay, thank you. Just on the size of the replication portfolio I guess just what I was checking there was when you gave a disclosure, I think at Q3 2022, you said the size of the book was about €461 billion. Obviously, that's grown from €461 to to €480.

Now, it seems like the book growth has outpaced the growth in actual customer deposits. I just wanted to check what's driving the size of the replication portfolio and can we expect that portfolio to continue to grow or be stable or maybe come down in the future?

Tanate Phutrakul
It's driven by flows by our customers. I think the expectation is that as maybe the market starts to slow down loan or deposit growth, then the replication portfolio will be less. If like we see in Q3, demand for deposits continue to come into the bank, then it will be more.

Amit Goel (Barclays)
You're seeing a pass through, I think you said, of 29%, is that correct at the moment?

Tanate Phutrakul
Yes. Year to date.

Amit Goel (Barclays)
Okay, thank you.

Operator
The next question comes from Flora Bocahut from Jefferies. Please go ahead.

Flora Bocahut (Jefferies)
Yes, thank you. The first question I had is actually around the ROE target of 12%. I think this is a target you have on the CET1 that would be 12.5%. You are obviously at 12% of the last four quarters, but that's on a CET1 that is north of 14.5%. The question here is really why stick to that target? I know you don't like to update those targets too often, but we've had many other banks updating their targets this year. So, is there anything that's holding you up from upgrading the ROE target towards 2025? Is there anything negative that you expect will change the picture? Then the second question is regarding the ongoing share buyback. I've been surprised by the speed at which it's been conducted so far in the sense, I know it's not in your hands that there is a mandate towards another investment bank, but in the sense that, at this space of buying just €4 million a day it would take beyond the deadline.

Can you just confirm that with certainty, the €1.5 billion buyback will be finished at the deadline, even though that implies a significant increase in the daily volumes that needs to be bought until the deadline of 18th of October. Thank you.

Steven van Rijswijk
Okay, thank you, Flora. On the share buyback, we can confirm with certainty the share buyback will be finalised in October. Then on the ROE target, look, we have said that we gave indications at the investor day presentation and that if we would give an update, we do that once a year after the 4Q results, and that's how we do it. Otherwise, we need to give updates every quarter, so we stick to that yearly cadence.

Operator
Thank you. I'm sorry, I was on mute. We'll take the next question from Guillaume Tiberghien from BNP Paribas Exane.

Guillaume Tiberghien (BNP Paribas Exane)
Good morning. Thanks for the question. The question relates to the RWA in the Wholesale division. I understand demand is weak and you expect it to remain subdued. I understand your models can go up and down depending on the model cycle, but I'm more interested in how you think about the strategy for the RWA development in the CID. What do you actually want to do? Do you want to continue to lend with lower density? lend less? Can you just elaborate a little bit about your strategy for growth in RWA in Wholesale? Thank you.

Steven van Rijswijk
Okay. Thanks for the question. Clearly, we are a bank that is focusing on very strong large corporates, and we have strong knowledge in a number of sectors, and we have had that for decades. We stick to those sectors and we stick to those corporates. There is not a change in risk structure or in risk appetite.

At the moment we do see some lending pick up in large lending deals, but at the same time, due to lower commodity prices, we also saw an impact in lower Trade & Commodity Finance, which outpaced that lending income. Markets remain relatively uncertain given also the economic outlook. But what we do work on is first of all to continue our strides to help customers to transition to more sustainable business models, and that's what we focus on.

Secondly, we're still very much an underwrite to hold bank, and we also work on better capital velocity, which basically means that we will increasingly also underwrite and then sell. That's what you have also partly seen now in the second quarter coming in, as part of the decrease in RWA in Wholesale Banking was because we started in our strategy, but also moving and doing more in capital velocity. Last but not least, also we deleveraged our exposure in Russia. We continue to do that. Currently, our total exposure in Russia is 1.7 billion, but came down from a couple hundred million higher earlier this year, and that has also led to some RWA release. Those are two factors I mentioned already and the strategy we have regarding Wholesale Banking lending and capital velocity.

Guillaume Tiberghien (BNP Paribas Exane)
Thank you. Can I just do a small follow up on the deposit data? I didn't hear earlier. Did you say you are at 29% at the end of the quarter?

Steven van Rijswijk
Until now we have 20%, but with the rate increase of the Netherlands as per August 15, the tracking will be 29%.

Guillaume Tiberghien (BNP Paribas Exane)
I see. Thank you.

Operator
The next question comes from Chris Hallam from Goldman Sachs. Please go ahead.

Chris Hallam (Goldman Sachs)
Yes. Morning everybody. Thanks for taking my questions. Just two of them. First, on capital allocation, you've talked a lot already about distribution, but if you look at the businesses, you're running well ahead of that ROE target at 12.5% CET1. Cost of risk is very low with those overlays still there. Given that, are there any business areas where you're now considering putting more capital to work versus when those targets were initially calibrated i.e. more capital-intensive areas? You touched on this already for the CIB, but just perhaps for the broader group. That's the first question.

Then a follow up is to an earlier question on deposit growth in Germany. Is there any colour you're able to give on the marginal cost of attracting those deposits? Obviously, there are some big headline deposit offers out there in Germany from some other players, and I was just wondering how we should think about marginal deposit funding cost versus the aggregate cost.

Steven van Rijswijk
On the first one, capital allocation, we will always look to optimise capital allocation. We have return on equity targets for Wholesale Banking, and business banking, and Retail Banking, and we price the marginal deal. We're not going to deviate from that because we now have more capital. We want to continue to grow with prudency in all the markets in which we're active. Big focus also in further growth in Germany, like I said, growth in retail customers and we want to strengthen our network position that we have as a Wholesale Bbank across the world. But again, we do that in the existing framework of pricing, the marginal deal to the return. If we can't make that and if we can't make the client return, we will not do it. No deviation from that. Secondly, on the deposit growth in Germany, that marketing campaign at the time was done at 3%, so we made money on that marketing campaign because the ECB rate at that time was already higher.

Operator
The next question comes from Farquhar Murray from Autonomous. Please go ahead.

Farquhar Murray (Autonomous)
Morning all. Two questions if I may. Firstly, on capital management, two competing signals in recent months. One, the cut in the O-SII buffer, and the other, the heavy draw down on the stress test. I just wondered if you could outline how those play through into the discussions on the 3Q update and more generally the dialogue with the ECB. On paper, I think the stress test should feed into the P2G in some way, so I wouldn't mind just some colour around that.

Then secondly, just coming back to Benoit's question on the Financial Markets NII. If I look back more than a decade, I don't have a period where FM NII was negative, though it is volatile, but your answer to Benoit seems to suggest that if I think rates remain more normal from here, I should build in a structurally negative NII for FM with a positive counterpart in Other income. Are we understanding you right there and how do I square it with the history? Thanks.

Steven van Rijswijk
Thank you. Regarding the lower capital buffer of the DNB, at the time that buffer came in, that was at the time that there was no three-pillar system in Europe. So, the ECB hasn't started yet, and there was no SRB and no European deposit system. And then, in that setting, local supervisors increased buffers for their large banks, let's put it too big to fill buffer. Increasingly, banks have increased their own capital and there is now that three pillar system in Europe. As a result of which that has led for DNB to in the end decrease the buffer. That means that those capital requirements that they set, they moved to approximately 10.7%, and therefore that's in line with our around 12.5%.

Regarding the stress test. The stress test is a stress test as there are many stress tests. We do a number of stress tests internally as well that we share with the ECB, with our supervisors, and that has no bearing currently on our 12.5% targets. We're remaining positive discussions with the ECB about next steps, that we will then need to take, and we will update you in the third quarter.

Farquhar Murray (Autonomous)
Thanks.

Tanate Phutrakul
Farquhar, on NII in Financial Markets, maybe a bit more nuance in the answer, it's three things. The absolute rates are higher, but it also depends on the product mix and also depends on the differences between major currencies, the arbitrage between euro dollar, for example. I wouldn't call it that you should be looking at a structural increase in NII of that such, but I remain that funding cost is higher, but that it just depends on these three things which remains volatile in the Financial Markets results.
Farquhar Murray (Autonomous)

Just a more general question, if I think of things as normalising from here, should I build in a structurally negative NII FM? Is that the permanent structural outcome from here?

Tanate Phutrakul
No, I think it just depends on movements you have, for example, trading opportunities, product mix from customers. I wouldn't structurally put it at the levels that you see in Q2, but at the same time, funding costs are high.

Farquhar Murray (Autonomous)
Equally, Should I maybe transition back to history? Would that be a more reasonable guesstimate?

Tanate Phutrakul
I would not say that would be a good guidance either in light of current interest rate environment.

Farquhar Murray (Autonomous)
Great. Many thanks.

Operator
The next question comes from Matt Clark from Mediobanca.

Matt Clark (Mediobanca)
Good morning, two questions please. Firstly, on risk weighted assets, looking at template CR-8 in your pillar three disclosure you've had a tailwind for IRB risk weighted assets from asset quality in the past few quarters and also a tailwind from the other

category there of a couple of billion per quarter. I was just hoping you could give some explanation there about why the asset quality is getting better. It's a bit counterintuitive, and what the other benefit to your risk weighted assets which has been quite meaningful.

Then secondly, on the cross-currency interest rate arbitrage trades. If this impact started around third quarter last year and you seem to be saying it's going to last a bit more into the third quarter this year, is it the right conclusion to draw that you put these trades on with a 12 months duration? Just trying to work out how long you are willing to tie up your balance sheet for in these trades as a general rule when the opportunity arises? Thanks.

Steven van Rijswijk
Okay. Tanate, the Treasury cross currency trades.

Tanate Phutrakul
That's trades and the environment for that trade continue to exist, but it should decline over the next three months, but guidance for 12 months, that I think just too many factors to factor in. I think the trade exists, it's going to decline somewhat in Q3.

Matt Clark (Mediobanca)
If I understand it right, you put these trades on for a defined term, and then you lock in at the inception, the economics, the spread, and then how much it impacts your NII will depend on the relative interest rates of US versus Euro, but the economics of the deal itself will be defined at the outset.

Tanate Phutrakul
Now I completely understand your question. These trades are tended to be short in duration.

Matt Clark (Mediobanca)
By short you mean?

Tanate Phutrakul
I don't think we're going to give our trading positions on an analyst call, but let's say that the trade exists, it would decline in Q3. That's our guide.

Matt Clark (Mediobanca)
Okay, thanks.

Steven van Rijswijk
Okay, Ljiljana, RWA.

Ljiljana Čortan
Good morning. As you know, RWA size and dynamics depend on a number of factors and it's subject to volatility based on both internal and external factors. The decrease due to asset quality is driven by several reasons. The most significant one is successful derisking of Russian exposure, which has taken a huge amount of our RWA in 2022 and is now at €4.5 billion compared to even 13.5 billion a year ago. That's one that is first.

Second one is clearly the structure and quality of our loan book impacts the RWA from the perspective of the tenor. What's the structure of your short term versus long term exposure, but as well what is collateral that you're having behind?
Third, there is clearly a dynamic in the portfolio where there are certain repayments of the higher rating classes, worse rating classes in favour of the ones better rated. All of these together might have offset some of the negative example impact from the environment like housing price. Let's not forget there as well, we do have a floor on some of our portfolios. So, these negative impacts from the environment might have been already encountered for. In general, that's the overall picture.

Matt Clark (Mediobanca)
Thank you, and specifically this Other line that's also been quite meaningful on that table, 1.7 billion of benefit this quarter.

Ljiljana Čortan
You would have to be more specific. Which exact line, because I do not have a template in front.

Matt Clark (Mediobanca)
Okay. I'll take it offline. Thank you.

Steven van Rijswijk
Then we take it offline with Media Relations. Sorry, Investor Relations. I'm being corrected.

Operator
We will take the next question from Anke Reingen from RBC.

Anke Reingen (RBC)
Yes, thank you for taking my question. Just two small ones please. On capital distribution, there is the comment about the roughly equal steps, could that be under review with your Q3 update because the commentary seems to be a bit more that it could potentially be a bit more.

Then secondly, on the costs, do you think the 7% growth year over year is a good indicator for the full year trend? Thank you.

Steven van Rijswijk (RBC)
Okay. With the roughly equal steps, we meant roughly equal steps in terms of CET level moves. If I translate that, if there's a bigger delta between 12.5% of where we are in our capital, we need to make bigger CET moves to come down. That's what we will reflect, and a few of other colleagues already said, "Hey, but mathematically that means that you would need to do more to get to those roughly equal steps, and I've confirmed that I have also made that same calculation".

With regards to the 7% run rate, that's indeed a clean cost increase of this quarter compared to the same quarter a year ago, is 7%. Which is inflation, but also the investments that we make in our digitalisation and marketing, and growth efforts for customers. That is a good run rate trend that we currently see.

Anke Reingen (RBC)
Thank you.

Operator
As there are no further questions that will conclude today's question and answer session. I will hand the call back to Mr. Van Rijswijk for any closing remarks.

Steven van Rijswijk
Yes, thank you Operator. That is the end of the conference call, but not before I thank Marieke Bakker, because she has been working vigilantly over the last number of years to keep us sharp and also have good conversation with all of you, and make all these fantastic presentations. So, I would like to thank her. She's going to work in another part of ING and we're very happy that she remains with ING, but I want to express my appreciation for Marieke. I would like to thank you all for again listening and for your questions. I wish you a great day and also wish you a great summer. Thank you.

Operator
Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.