New developments as of issuance of the auditor report

Since the issuance of the auditor's report on 17 March 2020 included in the NLB Group Annual Report 2019 and published on 2 April 2020, the world has been changing with a rapid pace due to the consequences the COVID-19 (hereinafter: coronavirus or COVID-19) has on the global economy and the economies where the NLB Group operates. This is to update the information on macroeconomic environment and outlook published in the NLB Group Annual Report 2019.

Macroeconomic environment

The COVID-19 outbreak in China is having unprecedented effects around the globe, both on people and economies. The deadly virus that has killed thousands and infected many more, has deeply affected economies. In order to contain it, governments around the world limited the social contacts and shut down the economies, while the WHO had to declare the pandemic. We also have shocks on both sides, supply and demand. Productions were halted, global trade chains were interrupted and consumption stalled or disabled. The extent of the social (and economic) restrictions depends on the level of the country's medical capabilities. The longer the imposed restrictions persist, more economic havoc they will cause.

Since the impact of coronavirus could be deeper and longer than originally expected, the countervailing economic measures should be unprecedented as well. We are already experiencing monetary measures aiming to ensure enough liquidity and smooth operations in the money markets and among financial intermediaries. Until now, Fed, ECB and other major central banks, have provided major stimulus on COVID-19 shock and expressed their "whatever it takes" commitments. Adopted enormous fiscal measures are meant to help the companies and households to overcome the economic shock caused by the coronavirus outbreak. Nevertheless, if the virus outbreak is not put under control soon and if the monetary and fiscal stimulus is not big enough, well targeted and has enough impact, the recession may be deeper and more severe. Each additional month of the lockdown is pushing the economies deeper into the recession by additional few percentage points.

At the time of writing, we expect that the global economy will experience a recession of around -2% in 2020. China's economic growth may diminish to only 2%, while the other emerging markets can face the recession as well, hence no more support for the global growth. The Eurozone, with already weak economic growth in 2019, could decrease by around 5% this year, which is also our expectation for Slovenia. The economic growth in the NLB Group's region could decrease by around 3% this year. This scenario is expected in case the coronavirus outbreak is put under control and the lockdowns are lifted by the end of May 2020. In this case we expect a U-shaped recession. With an additional month or two of lockdown, the recession will be deeper and as prolonged U-shape. If the outbreak takes longer and if we have also the second (external) wave of infections, we could experience a deep long-term recession with L-shape. The downside risks remain but with sufficient countervailing measures the worst scenarios can be avoided.

Governmental measures to mitigate the COVID-19

In order to slow down the COVID-19 epidemic, the governments of all countries in which the NLB Group operates are imposing severe restrictions on social interactions and movement of people. While such restrictions may be effective in preventing simultaneous infection of a large number of people and overburdening of health systems, they have adverse effects on economic activity which, unless addressed properly, may have long lasting negative consequences for the economy and financial stability of the affected countries.

Proposed fiscal package from Slovenia amounts to EUR 3 billion, which represents approximately 6% of total GDP. On 20 March 2020 Slovenia passed the first package of legislation intended to mitigate the effect of the epidemic on the economy. In addition to measures affecting public finances, such as extension of deadlines for submission of tax returns and payment of taxes and reimbursement of wage compensation payable to workers who have been temporarily laid off or quarantined, the package includes the Act on Intervention Measure on Deferred Payments of Borrower's Obligations *(Zakon o interventnem ukrepu odloga plačila obveznosti kreditojemalcev)* which requires banks operating in Slovenia, including NLB, to grant a 12 months' deferral of the payment of obligations to all borrowers who apply for such deferral and are able to demonstrate that they are unable to service their debt due to the consequence of the epidemic on their business and may, consequently, adversely affect the ability of NLB to effectively manage its assets. Similar measures were adopted or are proposed also in other countries were NLB Group operates.

NLB sees the Act on Intervention Measure on Deferred Payments of Borrower's Obligations as a part of short-term support measures for corporate and retail clients due to the systemic shock. Proposed short-term preventive measures refer mainly to clients asking for temporary deferral of payment of their obligations due to economic slowdown caused by the epidemic. In this respect NLB does not consider these measures as massive and systemic forbearance or restructuring in the first phase. Clients who apply for a moratorium, as a response to COVID-19 epidemic, will not be automatically classified as forbearance measures, as per IFRS 9 and the definition of default. NLB will assess the credit quality of the exposures benefiting from these measures and identify any situation of unlikeness to pay. In addition, the Act on Intervention Measure on Deferred Payments of Borrower's Obligations, enables the postponement of all contractual obligations not due on declaration of an epidemic, i.e. 12 March 2020.
Nevertheless, COVID-19 epidemic might have some negative impacts on the NLB Group's credit portfolio quality and related cost of risk. In addition, any long-term prolongation of COVID-19 epidemic might cause additional negative impacts on the NLB Group's business operations and related results.

Outlook considering COVID-19 implications

Following the indications of the outbreak of the COVID-19 in March in Slovenia and SEE, the Group has taken necessary measures to protect its customers and employees by ensuring safety conditions and making sure services offered by the Group are provided without any disruption. As the outbreak and spread of the coronavirus continues to evolve, it is challenging to predict the full extent and duration of its business and economic implications.

The overall slow-down of the economy will have a negative impact on new loan generation and consequently lower net interest income than previously expected. A negative effect is expected also on fees and commissions, of which most significant negative deviation is foreseen in relation to the card business and in payments.

Due to slower business operations linked to the moratorium and the crisis, some of the activities will be cancelled or postponed, which will reflect in lower costs. On the other hand, costs related to protection of health - hygiene, safety products and transportation, resulting from the current situation, will increase.

Cost of risk will increase due to the impact of worsened macroeconomic environment on risk profile of the loan portfolio, materiality will mostly depend on the length and severity of disruption in corporate operations and average retail income. Important factor, currently hard to assess, will be the impact of off-setting measures by governments, where special focus is on retail automatic stabilisers (special social transfers for employees and the self-employed affected by the crisis) and government guarantee schemes for liquidity of companies.

The recently adopted ECB measures allow NLB Group to benefit from the lower capital requirements, while due to ECB Recommendation on dividend distributions during the COVID-19 pandemic towards European banks, the dividend distributions timeline and capacity will be adjusted accordingly to reflect the implications of COVID-19.